MARKEL CORP
Form 10-Q
November 06, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2013

or

.. Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _______ to _______

Commission File Number: 001-15811

MARKEL CORPORATION
(Exact name of registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	54-1959284 (I.R.S. Employer Identification No.)

4521 Highwoods Parkway, Glen Allen, Virginia 23060-6148
(Address of principal executive offices)
(Zip Code)
(804) 747-0136
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer o Non-accelerated filer o Smaller reporting company o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
Number of shares of the registrant's common stock outstanding at October 30, 2013: 13,969,015

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets
(dollars in thousands)

	September 30, 2013 (unaudited)	December 31, 2012
ASSETS		
Investments, available-for-sale, at estimated fair value:		
Fixed maturities (amortized cost of $10,242,410 in 2013 and $4,562,278 in 2012)	$10,312,939	$4,979,283
Equity securities (cost of $1,511,463 in 2013 and $1,387,305 in 2012)	2,988,614	2,406,951
Short-term investments (estimated fair value approximates cost)	1,159,457	973,330
Total Investments	14,461,010	8,359,564
Cash and cash equivalents	2,115,322	863,766
Restricted cash and cash equivalents	600,171	109,415
Receivables	1,253,781	413,883
Reinsurance recoverable on unpaid losses	1,910,023	778,774
Reinsurance recoverable on paid losses	105,279	51,145
Deferred policy acquisition costs	260,230	157,465
Prepaid reinsurance premiums	437,435	110,332
Goodwill	1,008,205	674,930
Intangible assets	560,836	374,295
Other assets	1,096,285	663,019
Total Assets	$23,808,577	$12,556,588
LIABILITIES AND EQUITY		
Unpaid losses and loss adjustment expenses	$10,172,692	$5,371,426
Life and annuity benefits	1,482,998	—
Unearned premiums	2,307,266	1,000,261
Payables to insurance and reinsurance companies	385,734	103,212
Senior long-term debt and other debt (estimated fair value of $2,361,000 in 2013 and $1,688,000 in 2012)	2,250,479	1,492,550
Other liabilities	675,580	613,897
Total Liabilities	17,274,749	8,581,346
Redeemable noncontrolling interests	71,488	86,225
Commitments and contingencies		
Shareholders' equity:		
Common stock	3,277,488	908,980
Retained earnings	2,197,816	2,068,340
Accumulated other comprehensive income	982,119	911,337
Total Shareholders' Equity	6,457,423	3,888,657
Noncontrolling interests	4,917	360
Total Equity	6,462,340	3,889,017
Total Liabilities and Equity	$23,808,577	$12,556,588

See accompanying notes to consolidated financial statements.

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MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income and Comprehensive Income
(Unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(dollars in thousands, except per share data)			
OPERATING REVENUES				
Earned premiums	$919,723	$530,537	$2,269,129	$1,573,189
Net investment income	86,192	64,438	228,788	207,834
Net realized investment gains:				
Other-than-temporary impairment losses	—	(3,159)	(4,589)	(4,151)
Net realized investment gains, excluding other-than-temporary impairment losses	11,238	8,390	45,290	29,507
Net realized investment gains	11,238	5,231	40,701	25,356
Other revenues	174,512	165,569	504,680	385,778
Total Operating Revenues	1,191,665	765,775	3,043,298	2,192,157
OPERATING EXPENSES				
Losses and loss adjustment expenses	533,372	303,459	1,263,674	813,074
Underwriting, acquisition and insurance expenses	352,126	231,841	943,894	695,322
Amortization of intangible assets	16,848	7,959	37,755	25,078
Other expenses	166,566	145,339	459,642	343,462
Total Operating Expenses	1,068,912	688,598	2,704,965	1,876,936
Operating Income	122,753	77,177	338,333	315,221
Interest expense	30,619	24,692	82,754	69,068
Income Before Income Taxes	92,134	52,485	255,579	246,153
Income tax expense	25,167	811	70,673	45,998
Net Income	66,967	51,674	184,906	200,155
Net income attributable to noncontrolling interests	1,368	2,021	2,649	3,562
Net Income to Shareholders	$65,599	$49,653	$182,257	$196,593
OTHER COMPREHENSIVE INCOME				
Change in net unrealized gains on investments, net of taxes:				
Net holding gains arising during the period	$84,564	$100,630	$107,473	$246,056
Change in unrealized other-than-temporary impairment losses on fixed maturities arising during the period	(219)	(128)	(40)	(136)
Reclassification adjustments for net gains included in net income	(7,654)	(6,484)	(27,866)	(20,154)
Change in net unrealized gains on investments, net of taxes	76,691	94,018	79,567	225,766
Change in foreign currency translation adjustments, net of taxes	1,709	3,266	(9,931)	2,927
Change in net actuarial pension loss, net of taxes	410	522	1,146	1,487
Total Other Comprehensive Income	78,810	97,806	70,782	230,180
Comprehensive Income	145,777	149,480	255,688	430,335
Comprehensive income attributable to noncontrolling interests	1,368	2,026	2,649	3,520
Comprehensive Income to Shareholders	$144,409	$147,454	$253,039	$426,815

NET INCOME PER SHARE				
Basic	$4.69	$5.33	$15.38	$19.72
Diluted	$4.67	$5.32	$15.33	$19.67

See accompanying notes to consolidated financial statements.

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MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Equity
(Unaudited)

(dollars in thousands)	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity	Noncontrolling Interests	Total Equity	Redeemable Noncontrolling Interests
December 31, 2011	$891,507	$1,835,086	$ 660,920	$3,387,513	$ 602	$3,388,115	$ 74,231
Net income (loss)		196,593	—	196,593	(742)	195,851	4,304
Other comprehensive income (loss)		—	230,222	230,222	—	230,222	(42)
Comprehensive Income (Loss)				426,815	(742)	426,073	4,262
Issuance of common stock	8,803	—	—	8,803	—	8,803	—
Repurchase of common stock	—	(16,062)	—	(16,062)	—	(16,062)	—
Restricted stock units expensed	5,184	—	—	5,184	—	5,184	—
Acquisitions	—	—	—	—	—	—	7,896
Adjustment of redeemable noncontrolling interests	—	(6,484)	—	(6,484)	—	(6,484)	6,484
Other	347	—	—	347	(57)	290	(5,135)
September 30, 2012	$905,841	$2,009,133	$ 891,142	$3,806,116	$ (197)	$3,805,919	$ 87,738
December 31, 2012	$908,980	$2,068,340	$ 911,337	$3,888,657	$ 360	$3,889,017	$ 86,225
Net income (loss)		182,257	—	182,257	(443)	181,814	3,092
Other comprehensive income		—	70,782	70,782	—	70,782	—
Comprehensive Income (Loss)				253,039	(443)	252,596	3,092
Issuance of common stock	18,663	—	—	18,663	—	18,663	—
Repurchase of common stock	—	(56,862)	—	(56,862)	—	(56,862)	—
Restricted stock units expensed	20,182	—	—	20,182	—	20,182	—
Acquisition of Alterra	2,330,199	—	—	2,330,199	—	2,330,199	—
Adjustment of redeemable noncontrolling interests	—	3,101	—	3,101	—	3,101	(3,101)

Purchase of noncontrolling interest	(136)	—	—	(136)	—	(136)	(11,716)
Other	(400)	980	—	580	5,000	5,580	(3,012)
September 30, 2013	$3,277,488	$2,197,816	$ 982,119	$6,457,423	$ 4,917	$6,462,340	$ 71,488

See accompanying notes to consolidated financial statements.

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MARKEL CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30,	
	2013	2012
	(dollars in thousands)	
OPERATING ACTIVITIES		
Net income	$184,906	$200,155
Adjustments to reconcile net income to net cash provided by operating activities	357,551	39,390
Net Cash Provided By Operating Activities	542,457	239,545
INVESTING ACTIVITIES		
Proceeds from sales of fixed maturities and equity securities	497,364	193,514
Proceeds from maturities, calls and prepayments of fixed maturities	851,194	354,489
Cost of fixed maturities and equity securities purchased	(737,515)	(390,927)
Net change in short-term investments	(177,311)	(183,748)
Proceeds from sales of equity method investments	228,001	—
Cost of equity method investments	(24,878)	(38,650)
Change in restricted cash and cash equivalents	(76,259)	(23,271)
Additions to property and equipment	(36,677)	(33,489)
Acquisitions, net of cash acquired	(13,354)	(246,182)
Other	2,912	(8,996)
Net Cash Provided (Used) By Investing Activities	513,477	(377,260)
FINANCING ACTIVITIES		
Additions to senior long-term debt and other debt	563,913	461,360
Repayment and retirement of senior long-term debt and other debt	(320,094)	(263,120)
Repurchases of common stock	(56,862)	(16,062)
Issuance of common stock	18,663	8,803
Purchase of redeemable noncontrolling interests	(11,852)	(320)
Distributions to noncontrolling interests	(3,983)	(4,821)
Other	(246)	(15,213)
Net Cash Provided By Financing Activities	189,539	170,627
Effect of foreign currency rate changes on cash and cash equivalents	6,083	3,613
Increase in cash and cash equivalents	1,251,556	36,525
Cash and cash equivalents at beginning of period	863,766	703,259
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$2,115,322	$739,784

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

Markel Corporation is a diverse financial holding company serving a variety of niche markets. Markel Corporation's principal business markets and underwrites specialty insurance products and programs. Markel Corporation also owns interests in various industrial and service businesses that operate outside of the specialty insurance marketplace.

On May 1, 2013 (the Acquisition Date), Markel Corporation completed the acquisition of 100% of the issued and outstanding common stock of Alterra Capital Holdings Limited (Alterra) pursuant to an agreement dated December 18, 2012 which provided for the merger of Alterra with one of Markel Corporation's subsidiaries. Total purchase consideration was $3.3 billion. Alterra was a Bermuda-headquartered global enterprise providing diversified specialty insurance and reinsurance products to corporations, public entities and other property and casualty insurers.

The consolidated balance sheet as of September 30, 2013, the related consolidated statements of income and comprehensive income for the quarters and nine months ended September 30, 2013 and 2012, and the consolidated statements of changes in equity and cash flows for the nine months ended September 30, 2013 and 2012 are unaudited. In the opinion of management, all adjustments necessary for fair presentation of such consolidated financial statements have been included. Such adjustments consist only of normal, recurring items. Interim results are not necessarily indicative of results of operations for the entire year. The consolidated balance sheet as of December 31, 2012 was derived from Markel Corporation's audited annual consolidated financial statements.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include the accounts of Markel Corporation and its subsidiaries (the Company). All significant intercompany balances and transactions have been eliminated in consolidation. The consolidated financial statements include the results of operations and cash flows of Alterra from the Acquisition Date to September 30, 2013 and not in any prior periods, except with respect to the Supplemental Pro Forma Information included in note 3. The Company consolidates the results of its non-insurance subsidiaries on a one-month lag. Certain prior year amounts have been reclassified to conform to the current presentation.

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results may differ materially from the estimates and assumptions used in preparing the consolidated financial statements.

The consolidated financial statements and notes are presented as permitted by Form 10-Q and do not contain certain information included in the Company's annual consolidated financial statements and notes. Readers are urged to review the Company's 2012 Annual Report on Form 10-K for a more complete description of the Company's business and accounting policies.

2. Recent Accounting Pronouncements

Effective January 1, 2013, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2013-02, Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income, which amends FASB Accounting Standards Codification (ASC) 220, Comprehensive Income, to improve the reporting of reclassifications out of accumulated other comprehensive income. ASU No. 2013-02 requires information about reclassifications out of accumulated other comprehensive income to be reported in one place, by component. The guidance also requires disclosure of the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under

U.S. GAAP to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. The adoption of this guidance did not have an impact on the Company's financial position, results of operations or cash flows. The Company has included the additional disclosures required by ASU No. 2013-02 in note 14.

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3. Acquisitions

Acquisition of Alterra

a)Overview. On May 1, 2013, the Company completed the acquisition of 100% of the issued and outstanding common stock of Alterra pursuant to an agreement dated December 18, 2012 (the Merger Agreement) which provided for the merger of Alterra with one of the Company's subsidiaries. Alterra was a Bermuda-headquartered global enterprise providing diversified specialty property and casualty insurance and reinsurance products to corporations, public entities and other property and casualty insurers. The acquisition of Alterra creates additional size and scale, providing additional insurance and investment opportunities for the Company. As a result of the acquisition of Alterra, the Company formed a new operating segment, the Alterra segment. Results attributable to Alterra's property and casualty insurance and reinsurance business are included in the Alterra segment. Previously, Alterra also offered life and annuity reinsurance products. In 2010, Alterra ceased writing life and annuity reinsurance contracts and placed this business into run-off. Results attributable to the run-off of Alterra's life and annuity reinsurance business are included in the Company's Other Insurance (Discontinued Lines) segment. See note 6 for further discussion of the Company's operating segments.

Pursuant to the terms of the Merger Agreement, on the Acquisition Date, equity holders of Alterra received, in exchange for each share of Alterra common stock held (other than restricted shares that did not vest in connection with the transaction), (1) 0.04315 shares of the Company's common stock and (2) $10.00 in cash. In total, equity holders of Alterra received total consideration of $3.3 billion, consisting of cash consideration of $964.3 million and stock consideration of 4.3 million shares of the Company's common stock.

Following the acquisition, the Company's board of directors consists of all 10 members from its pre-acquisition board of directors and two additional members who were designated by Alterra and approved by the Company's Nominating/Corporate Governance Committee.

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b)Purchase Price. The Company's total purchase price for Alterra as of the Acquisition Date was calculated as follows:

(in thousands, except per share amounts)	
Shares of Alterra common stock outstanding as of the Acquisition Date	96,433
Exchange ratio per the Merger Agreement	0.04315
Markel share issuance to Alterra shareholders	4,161
Shares of Alterra restricted stock outstanding as of the Acquisition Date	2,239
Incentive award ratio per the Merger Agreement	0.06252
Markel restricted stock issuance to Alterra restricted stock holders	140
Multiplied by Markel's weighted average stock price on April 30, 2013 (1)	$529.59
Markel share and restricted stock issuance consideration, net of taxes	$2,267,648
Alterra common shares outstanding as of the Acquisition Date that received cash consideration	96,433
Multiplied by cash price per share component per the Merger Agreement	$10.00
Markel cash consideration	$964,330
Fair value of Markel warrant issuance to Alterra warrant holders as of the Acquisition Date	$73,685
Fair value of Markel stock option issuance to Alterra stock option holders as of the Acquisition Date, net of taxes	$12,335
Fair value of partially vested Markel restricted stock unit issuance as of the Acquisition Date, net of taxes	$6,867
Unrecognized compensation on unvested restricted stock and restricted stock units	$(20,572)
Total acquisition consideration	$3,304,293

(1) The fair value of the shares issued by the Company was calculated as the weighted average price of the Company's stock on April 30, 2013, the day preceding the Acquisition Date.

As part of the consideration, the Company issued replacement warrants, options and restricted stock awards to holders of Alterra warrants, options and restricted stock awards. The acquisition consideration related to the options, restricted stock awards and partially vested restricted stock units issued was net of income taxes of $1.9 million, $10.1 million and $0.7 million, respectively. See note 13 for additional information about the equity awards issued in connection with the acquisition.

c)Fair Value of Net Assets Acquired and Liabilities Assumed. The purchase price was allocated to the acquired assets and liabilities of Alterra based on estimated fair values at the Acquisition Date. The Company recognized goodwill of $337.0 million, all of which was preliminarily recorded within the Alterra segment and is primarily attributable to Alterra's assembled workforce and synergies that are expected to result upon integration of Alterra into the Company's insurance operations and investing activities. The Company estimates that none of the goodwill that was recorded will be deductible for income tax purposes. The Company also recognized indefinite lived intangible assets of $37.5 million and other intangible assets of $150 million, which will be amortized over a weighted average period of 17 years.

The Company has not completed the process of determining the fair value of the intangible assets acquired, unpaid losses and loss adjustment expenses and deferred taxes. These valuations will be completed within the measurement period, which cannot exceed 12 months from the Acquisition Date. As a result, the fair value recorded for these items is a provisional estimate and may be subject to adjustment. Once completed, any adjustments resulting from the valuations may impact the individual amounts recorded for assets acquired and liabilities assumed, as well as the residual goodwill.

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The following table summarizes the provisional fair values of the assets acquired and liabilities assumed at the Acquisition Date.

(dollars in thousands)	
ASSETS	
Investments	$6,407,841
Cash and cash equivalents	1,036,274
Restricted cash and cash equivalents	414,497
Receivables	866,388
Reinsurance recoverable on unpaid losses	1,169,084
Reinsurance recoverable on paid losses	80,672
Prepaid reinsurance premiums	317,445
Other assets	834,024
LIABILITIES	
Unpaid losses and loss adjustment expenses	4,719,461
Life and annuity benefits	1,477,482
Unearned premiums	1,075,610
Payables to insurance and reinsurance companies	342,858
Senior long-term debt	512,463
Other liabilities	218,523
Net assets	2,779,828
Goodwill	336,965
Intangible assets	187,500
Acquisition date fair value	$3,304,293

An explanation of the significant adjustments for fair value and the related impact on amortization is as follows:

- Investments - Investments acquired include a net increase of $223.1 million to adjust the historical carrying amount of Alterra's investments to their estimated fair value as of the Acquisition Date. The difference in the par value and estimated fair value of Alterra's fixed maturity securities investments as of the Acquisition Date, $552.4 million, will be amortized to net investment income over the term of the underlying securities.
- Intangible assets - Establish the provisional estimated fair value of intangible assets related to Alterra (see below for further detail).
- Unearned Premiums - Unearned premiums acquired include a decrease of $176.3 million to adjust the carrying value of Alterra's historical unearned premiums to fair value as of the Acquisition Date. The adjustment consists of the present value of the expected underwriting profit within the unearned premiums liability less costs to service the related policies and a risk premium. This adjustment will be amortized to underwriting, acquisition and insurance expenses over a weighted average period of approximately one year, as the contracts for business in-force as of the Acquisition Date expire.
- Unpaid losses and loss adjustment expenses - Unpaid losses and loss adjustment expenses acquired include a provisional increase of $120.8 million to adjust the carrying value of Alterra's historical unpaid losses and loss adjustment expenses, net of related reinsurance recoverable, to fair value as of the Acquisition Date. The estimated fair value consists of the present value of the expected net loss and loss adjustment expense payments plus a risk premium. This adjustment, plus the $26.5 million unamortized fair value adjustment included in Alterra's historical unpaid losses and loss adjustment expenses, will be amortized to losses and loss adjustment expenses over a weighted average period of approximately five years, based on the estimated payout pattern of net reserves as of the Acquisition Date.
- Life and Annuity Benefits - Life and annuity benefits acquired include an increase of $329.6 million to adjust the carrying value of Alterra's historical life and annuity benefits to fair value as of the Acquisition Date. The estimated fair value consists of the present value of the expected net life and annuity benefit payments plus a risk premium. See note 8 for detail regarding accounting for life and annuity benefits.

- Senior long-term debt - Senior long-term debt acquired includes an increase of $71.9 million to adjust the carrying value of Alterra's senior long-term debt to its estimated fair value based on prevailing interest rates and other factors as of the Acquisition Date. This adjustment will be amortized to interest expense over the term of the notes. See note 9.

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The following table summarizes the provisional intangible assets recorded in connection with the acquisition, and as of September 30, 2013.

(dollars in thousands)	Amount	Economic Useful Life
Customer relationships	$113,000	18 years
Broker relationships	18,000	18 years
Technology	18,000	10 years
Trade names	1,000	One year
Lloyd's syndicate capacity	12,000	Indefinite
Insurance licenses	25,500	Indefinite
Intangible assets, before amortization, as of the Acquisition Date	187,500	
Amortization (from the Acquisition Date through September 30, 2013)	4,246	
Net intangible assets as of September 30, 2013	$183,254	

Customer relationships represent policyholder relationships and the network of insurance companies through which Alterra conducts its operations. The fair value of customer relationships and broker relationships was estimated using the income approach. Critical inputs into the valuation model for customer relationships and broker relationships include estimates of expected premium and attrition rates, and discounting at a weighted average cost of capital. Technology represents the intangible asset related to Alterra's internally developed software and was valued using the income approach.

The fair value of Lloyd's syndicate capacity and insurance licenses was estimated using the market approach. Lloyd's syndicate capacity represents Alterra's authorized premium income limit to write insurance business in the Lloyd's market. Alterra's proportionate share of Syndicates 1400 and 2526, the syndicates through which it conducts its Lloyd's operations, is 100% and approximately 20%, respectively. The capacity is renewed annually at no cost to the Company but may be freely purchased or sold, subject to Lloyd's approval. The ability to write insurance business within the syndicate capacity is indefinite with the premium income limit being set annually by the Company, subject to Lloyd's approval.

d)Income Taxes. As a result of the acquisition, Alterra and its non-U.S. subsidiaries became controlled foreign corporations subject to U.S. income tax at a statutory rate of 35%. The acquisition was taxable to U.S. shareholders of Alterra, and Markel has elected to treat it as an asset acquisition under section 338(g) of the U.S. Internal Revenue Code of 1986 (IRC), as amended.

Effective May 1, 2013, the Company made an IRC section 953(d) election with respect to Markel Bermuda Limited (Markel Bermuda, formerly known as Alterra Bermuda Limited), a wholly-owned subsidiary of Alterra. As a result of the 953(d) election, Markel Bermuda is treated as a domestic corporation for U.S. tax purposes and, accordingly, was required to record deferred taxes at the 35% statutory U.S. rate.

As part of the provisional allocation of the purchase price, the Company recorded net deferred tax assets of $299.0 million. Of this amount, $320.0 million represents deferred tax assets related to accrued losses and loss adjustment expenses and life and annuity benefits, which were partially offset by deferred tax liabilities of $56.8 million related to the estimated fair value of the intangible assets recorded. Other net deferred tax assets recorded primarily relate to differences between financial reporting and tax bases of the acquired assets and liabilities as of the Acquisition Date. At September 30, 2013, earnings of Alterra's foreign subsidiaries are considered reinvested indefinitely, consistent with the Company's other foreign subsidiaries, and no provision for deferred U.S. income tax has been recorded. As of September 30, 2013, the provisional allocation of the purchase price reflects an increase of $43.2 million in the amount recorded for net deferred tax assets from the allocation reported at June 30, 2013 and a corresponding reduction in the amount recorded for goodwill.

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e)Transaction and Acquisition-Related Costs. The following table summarizes transaction and acquisition-related costs incurred by the Company in connection with the acquisition, all of which were included in underwriting, acquisition and insurance expenses in the consolidated statements of income and comprehensive income.

(dollars in thousands)	Quarter Ended September 30, 2013	Nine Months Ended September 30, 2013
Transaction costs	$—	$15,981
Acquisition-related costs:		
Severance costs	3,519	31,734
Stay bonuses	3,906	9,981
Acceleration of Alterra long-term incentive compensation awards and restricted stock awards	1,083	12,621
Total transaction and acquisition-related costs	$8,508	$70,317

Transaction costs primarily consist of due diligence, legal and investment banking costs. Per the terms of the Merger Agreement, transaction costs attributable to Alterra were recorded and paid by Alterra prior to the Acquisition Date ($23.0 million) and are not included within the Company's consolidated statements of income and comprehensive income.

In connection with the acquisition, Alterra instituted a retention plan for certain employees under which Alterra committed to the payment of stay bonuses to such employees one year from the Acquisition Date, provided they remain employed with the Company through that date. Payments may be accelerated for certain qualifying employment terminations.

Prior to its acquisition by the Company, Alterra granted long term incentive awards to certain employees to be paid in the form of cash on March 1, 2016, provided they remain employed with the Company on that date. Payments may be accelerated prior to March 1, 2016 for certain qualifying employment terminations. Additionally, as part of the purchase consideration, the Company issued replacement restricted stock awards to holders of Alterra restricted stock awards. As a result of separations made in connection with the acquisition, the Company recognized expense totaling $1.1 million and $12.6 million related to the acceleration of certain of these awards during the quarter and nine months ended September 30, 2013, respectively.

f)Financial Results. The following table summarizes the results of Alterra since the Acquisition Date that have been included within the Company's consolidated statements of income and comprehensive income.

(dollars in thousands)	Quarter Ended September 30, 2013	Nine Months Ended September 30, 2013
Operating revenues	$314,200	$557,446
Net loss to shareholders	$(11,312)	$(67,055)

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g)Supplemental Pro Forma Information. Alterra's results have been included in the Company's Consolidated Financial Statements from the Acquisition Date to September 30, 2013. The following table presents unaudited pro forma consolidated information for the quarter and nine months ended September 30, 2013 and 2012 and assumes the Company's acquisition of Alterra occurred on January 1, 2012. The pro forma financial information is presented for informational purposes only and does not necessarily reflect the results that would have occurred had the acquisition taken place on January 1, 2012, nor is it necessarily indicative of future results. Significant adjustments used to determine pro forma results include amortization of intangible assets and amortization of fair value adjustments discussed in c) above, and the corresponding income tax effects. The Company also excluded certain charges from the pro forma results, including transaction costs incurred by the Company ($16.0 million) and Alterra ($23.0 million) totaling $39.0 million for the nine months ended September 30, 2013, severance costs attributable to the acquisition totaling $3.5 million and $31.7 million for the quarter and nine months ended September 30, 2013, respectively, and stay bonuses of $3.9 million and $10.0 million for the quarter and nine months ended September 30, 2013, respectively. The acceleration of compensation expense during the quarter and nine months ended September 30, 2013 related to Alterra's long-term incentive compensation awards and restricted stock awards was attributable to the acquisition; however, the incremental expense recognized during the period only represents a timing difference in the recognition of expense. Therefore, it was not excluded from the pro forma underwriting results.

	Pro Forma Quarter Ended September 30,		Pro Forma Nine Months Ended September 30,	
(in thousands, except per share amounts)	2013	2012	2013	2012
Earned premiums	$919,723	$862,534	$2,717,732	$2,592,818
Operating revenues	1,234,380	1,146,994	3,629,659	3,365,605
Net income to shareholders	90,910	60,090	298,970	265,664
U.S. GAAP combined ratio (1)	95 %	102 %	95 %	96 %
Basic net income per share	$6.49	$4.29	$21.33	$18.96
Diluted net income per share	$6.47	$4.27	$21.24	$18.90
Weighted average common shares outstanding:				
Basic	14,001	14,015	14,014	14,012
Diluted	14,057	14,067	14,075	14,060

(1) The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

Acquisition of Essentia

On January 1, 2013, the Company completed its acquisition of 100% of the outstanding shares of Essentia Insurance Company, a company that underwrites insurance exclusively for Hagerty Insurance Agency and Hagerty Classic Marine Insurance Agency (collectively, Hagerty) throughout the United States. Hagerty offers insurance for classic cars, vintage boats, motorcycles and related automotive collectibles. The Company recognized intangible assets of $35.4 million associated with this acquisition, which includes $25.0 million of customer relationships to be amortized over a weighted average period of six years. Results attributable to this acquisition are included in the Specialty Admitted segment.

Offer to Acquire Abbey Protection

On October 9, 2013, the Company made an offer to purchase the entire issued and to be issued share capital of Abbey Protection plc (Abbey), an integrated specialist insurance and consultancy group, for a total purchase price of approximately £116.5 million (approximately $187.4 million as of October 9, 2013). The acquisition is subject to a number of conditions, including shareholder and regulatory approvals in the United Kingdom. If approved, the transaction is expected to close in January 2014. Abbey's business is focused on the underwriting and sale of insurance products to small and medium enterprises and affinity groups in the United Kingdom providing protection against legal expenses and professional fees incurred as a result of legal actions or investigations by tax authorities, as well as providing a range of complementary legal, professional and reinsurance services.

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4. Investments

a)The following tables summarize the Company's available-for-sale investments.

	September 30, 2013				
(dollars in thousands)	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Unrealized Other-Than-Temporary Impairment Losses	Estimated Fair Value
Fixed maturities:					
U.S. Treasury securities and obligations of U.S. government agencies	$1,257,855	$10,933	$(24,660)	$—	$1,244,128
Obligations of states, municipalities and political subdivisions	2,739,483	135,139	(23,561)	—	2,851,061
Foreign governments	1,435,249	34,323	(45,888)	—	1,423,684
Commercial mortgage-backed securities	401,036	116	(10,443)	—	390,709
Residential mortgage-backed securities	927,880	12,364	(12,012)	(2,258)	925,974
Asset-backed securities	217,394	261	(1,779)	—	215,876
Corporate bonds	3,263,513	67,385	(62,519)	(6,872)	3,261,507
Total fixed maturities	10,242,410	260,521	(180,862)	(9,130)	10,312,939
Equity securities:					
Insurance, banks and other financial institutions	404,923	540,749	(241)	—	945,431
Industrial, consumer and all other	1,106,540	939,612	(2,969)	—	2,043,183
Total equity securities	1,511,463	1,480,361	(3,210)	—	2,988,614
Short-term investments	1,159,460	3	(6)	—	1,159,457
Investments, available-for-sale	$12,913,333	$1,740,885	$(184,078)	$(9,130)	$14,461,010

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(dollars in thousands)	December 31, 2012 Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Unrealized Other-Than-Temporary Impairment Losses	Estimated Fair Value
Fixed maturities:					
U.S. Treasury securities and obligations of U.S. government agencies	$297,663	$19,844	$—	$—	$317,507
Obligations of states, municipalities and political subdivisions	2,586,867	245,057	(362)	—	2,831,562
Foreign governments	503,844	52,764	—	—	556,608
Residential mortgage-backed securities	202,644	14,996	(5)	(2,258)	215,377
Asset-backed securities	13,828	517	—	—	14,345
Corporate bonds	957,432	93,395	(121)	(6,822)	1,043,884
Total fixed maturities	4,562,278	426,573	(488)	(9,080)	4,979,283
Equity securities:					
Insurance, banks and other financial institutions	508,771	389,434	(138)	—	898,067
Industrial, consumer and all other	878,534	637,783	(7,433)	—	1,508,884
Total equity securities	1,387,305	1,027,217	(7,571)	—	2,406,951
Short-term investments	973,318	26	(14)	—	973,330
Investments, available-for-sale	$6,922,901	$1,453,816	$(8,073)	$(9,080)	$8,359,564

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b)The following tables summarize gross unrealized investment losses by the length of time that securities have continuously been in an unrealized loss position.

	September 30, 2013					
	Less than 12 months		12 months or longer		Total	
(dollars in thousands)	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses
Fixed maturities:						
U.S. Treasury securities and obligations of U.S. government agencies	$652,752	$(24,660)	$—	$—	$652,752	$(24,660)
Obligations of states, municipalities and political subdivisions	307,119	(23,439)	3,196	(122)	310,315	(23,561)
Foreign governments	907,456	(45,888)	—	—	907,456	(45,888)
Commercial mortgage-backed securities	378,001	(10,443)	—	—	378,001	(10,443)
Residential mortgage-backed securities	455,942	(14,269)	166	(1)	456,108	(14,270)
Asset-backed securities	189,070	(1,779)	—	—	189,070	(1,779)
Corporate bonds	2,127,583	(69,391)	—	—	2,127,583	(69,391)
Total fixed maturities	5,017,923	(189,869)	3,362	(123)	5,021,285	(189,992)
Equity securities:						
Insurance, banks and other financial institutions	11,518	(241)	—	—	11,518	(241)
Industrial, consumer and all other	51,261	(2,957)	125	(12)	51,386	(2,969)
Total equity securities	62,779	(3,198)	125	(12)	62,904	(3,210)
Short-term investments	525,986	(6)	—	—	525,986	(6)
Total	$5,606,688	$(193,073)	$3,487	$(135)	$5,610,175	$(193,208)

At September 30, 2013, the Company held 1,569 securities with a total estimated fair value of $5.6 billion and gross unrealized losses of $193.2 million. Of these 1,569 securities, 12 securities had been in a continuous unrealized loss position for one year or longer and had a total estimated fair value of $3.5 million and gross unrealized losses of $0.1 million. Of these securities, 10 securities were fixed maturities and two were equity securities. The Company does not intend to sell or believe it will be required to sell these fixed maturities before recovery of their amortized cost. The Company has the ability and intent to hold these equity securities for a period of time sufficient to allow for the anticipated recovery of their fair value.

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	December 31, 2012					
	Less than 12 months		12 months or longer		Total	
(dollars in thousands)	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses	Estimated Fair Value	Gross Unrealized Holding and Other-Than-Temporary Impairment Losses
Fixed maturities:						
Obligations of states, municipalities and political subdivisions	$2,833	$(46)	$3,616	$(316)	$6,449	$(362)
Residential mortgage-backed securities	364	(2,260)	201	(3)	565	(2,263)
Corporate bonds	—	(6,822)	3,860	(121)	3,860	(6,943)
Total fixed maturities	3,197	(9,128)	7,677	(440)	10,874	(9,568)
Equity securities:						
Insurance, banks and other financial institutions	2,431	(138)	—	—	2,431	(138)
Industrial, consumer and all other	82,109	(7,310)	1,983	(123)	84,092	(7,433)
Total equity securities	84,540	(7,448)	1,983	(123)	86,523	(7,571)
Short-term investments	228,820	(14)	—	—	228,820	(14)
Total	$316,557	$(16,590)	$9,660	$(563)	$326,217	$(17,153)

At December 31, 2012, the Company held 35 securities with a total estimated fair value of $326.2 million and gross unrealized losses of $17.2 million. Of these 35 securities, 10 securities had been in a continuous unrealized loss position for one year or longer and had a total estimated fair value of $9.7 million and gross unrealized losses of $0.6 million. Of these securities, eight securities were fixed maturities and two were equity securities.

The Company completes a detailed analysis each quarter to assess whether the decline in the fair value of any investment below its cost basis is deemed other-than-temporary. All securities with unrealized losses are reviewed. The Company considers many factors in completing its quarterly review of securities with unrealized losses for other-than-temporary impairment, including the length of time and the extent to which fair value has been below cost and the financial condition and near-term prospects of the issuer. For equity securities, the ability and intent to hold the security for a period of time sufficient to allow for anticipated recovery is considered. For fixed maturities, the Company considers whether it intends to sell the security or if it is more likely than not that it will be required to sell the security before recovery, the implied yield-to-maturity, the credit quality of the issuer and the ability to recover all amounts outstanding when contractually due.

For equity securities, a decline in fair value that is considered to be other-than-temporary is recognized in net income based on the fair value of the security at the time of assessment, resulting in a new cost basis for the security. For fixed maturities where the Company intends to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost, a decline in fair value is considered to be other-than-temporary and is recognized in net income based on the fair value of the security at the time of assessment, resulting in a new cost basis for the security. If the decline in fair value of a fixed maturity below its amortized cost is considered to be other-than-temporary based upon other considerations, the Company compares the estimated present value of the cash flows expected to be collected to the amortized cost of the security. The extent to which the estimated present value of the cash flows expected to be collected is less than the amortized cost of the security represents the credit-related portion of the other-than-temporary impairment, which is recognized in net income, resulting in a new cost basis for the security. Any remaining decline in fair value represents the non-credit portion of the other-than-temporary impairment, which is recognized in other comprehensive income. The discount rate used to calculate the estimated present value of the cash flows expected to be collected is the effective interest rate implicit for the security at the date of purchase.

When assessing whether it intends to sell a fixed maturity or if it is likely to be required to sell a fixed maturity before recovery of its amortized cost, the Company evaluates facts and circumstances including decisions to reposition the investment portfolio, potential sales of investments to meet cash flow needs and, ultimately, current market prices. Additional information on the methodology and significant inputs, by security type, that the Company used to determine the amount of credit loss recognized on fixed maturities with declines in fair value below amortized cost that were considered to be other-than-temporary is provided below.

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Residential / Commercial mortgage-backed securities. For mortgage-backed securities, credit impairment is assessed by estimating future cash flows from the underlying mortgage loans and interest payments. The cash flow estimate incorporates actual cash flows from the mortgage-backed securities through the current period and then projects the remaining cash flows using a number of assumptions, including prepayment rates, default rates, recovery rates on foreclosed properties and loss severity assumptions. Management develops specific assumptions using market data and internal estimates, as well as estimates from rating agencies and other third party sources. Default rates are estimated by considering current underlying mortgage loan performance and expectations of future performance. Estimates of future cash flows are discounted to present value. If the present value of expected cash flows is less than the amortized cost, the Company recognizes the estimated credit loss in net income.

Corporate bonds and obligations of states, municipalities and political subdivisions. For corporate bonds and obligations of states, municipalities and political subdivisions, credit impairment is assessed by evaluating the underlying issuer. As part of this assessment, the Company analyzes various factors, including the following:

- fundamentals of the issuer, including current and projected operating results, current liquidity position and ability to raise capital;
- fundamentals of the industry in which the issuer operates;
- expectations of defaults and recovery rates;
- changes in ratings by rating agencies;
- other relevant market considerations; and
- receipt of interest payments.

Default probabilities and recovery rates from rating agencies are key factors used in calculating the credit loss. Additional research of the industry and issuer is completed to determine if there is any current information that may affect the fixed maturity or its issuer in a negative manner and require an adjustment to the cash flow assumptions.

c)The amortized cost and estimated fair value of fixed maturities at September 30, 2013 are shown below by contractual maturity.

(dollars in thousands)	Amortized Cost	Estimated Fair Value
Due in one year or less	$900,263	$905,564
Due after one year through five years	3,151,362	3,220,106
Due after five years through ten years	2,227,954	2,277,491
Due after ten years	2,416,521	2,377,219
	8,696,100	8,780,380
Commercial mortgage-backed securities	401,036	390,709
Residential mortgage-backed securities	927,880	925,974
Asset-backed securities	217,394	215,876
Total fixed maturities	$10,242,410	$10,312,939

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d)The following table presents the components of net investment income.

(dollars in thousands)	Quarter Ended September 30, 2013	Quarter Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Interest:				
Municipal bonds (tax-exempt)	$20,347	$22,508	$62,307	$68,287
Municipal bonds (taxable)	7,452	5,670	19,467	17,055
Other taxable bonds	38,211	25,335	93,565	82,930
Short-term investments, including overnight deposits	1,042	721	2,316	1,995
Dividends on equity securities	12,059	10,128	35,600	30,586
Change in fair value of credit default swap	1,660	1,480	8,860	13,681
Other	9,004	875	16,036	(356)
	89,775	66,717	238,151	214,178
Investment expenses	(3,583)	(2,279)	(9,363)	(6,344)
Net investment income	$86,192	$64,438	$228,788	$207,834

e)Cumulative credit losses recognized in net income on fixed maturities where other-than-temporary impairment was identified and a portion of the other-than-temporary impairment was included in other comprehensive income were $21,370 as of September 30, 2013 and 2012. There were no changes in cumulative credit losses for the quarter and nine months ended September 30, 2013 or 2012.

f)The following table presents net realized investment gains and the change in net unrealized gains on investments.

(dollars in thousands)	Quarter Ended September 30, 2013	Quarter Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Realized gains:				
Sales of fixed maturities	$4,933	$2,576	$6,031	$7,863
Sales of equity securities	24,648	10,403	58,563	25,865
Other	398	—	451	655
Total realized gains	29,979	12,979	65,045	34,383
Realized losses:				
Sales of fixed maturities	(18,741)	(118)	(19,585)	(457)
Sales of equity securities	—	(383)	(170)	(331)
Other-than-temporary impairments	—	(3,159)	(4,589)	(4,151)
Other	—	(4,088)	—	(4,088)
Total realized losses	(18,741)	(7,748)	(24,344)	(9,027)
Net realized investment gains	$11,238	$5,231	$40,701	$25,356
Change in net unrealized gains on investments:				
Fixed maturities	$(8,679)	$37,488	$(346,476)	$82,078
Equity securities	117,899	98,964	457,505	248,214
Short-term investments	(13)	18	(15)	13
Net increase	$109,207	$136,470	$111,014	$330,305

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g)The following table presents other-than-temporary impairment losses recognized in net income and included in net realized investment gains by investment type.

	Quarter Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	2013	2012	2013	2012
Fixed maturities:				
Obligations of states, municipalities and political subdivisions	$—	$—	$(1,242)	$—
Residential mortgage-backed securities	—	—	(523)	—
Total fixed maturities	—	—	(1,765)	—
Equity securities:				
Insurance, banks and other financial institutions	—	(1,615)	—	(2,441)
Industrial, consumer and all other	—	(1,544)	(2,824)	(1,710)
Total equity securities	—	(3,159)	(2,824)	(4,151)
Total	$—	$(3,159)	$(4,589)	$(4,151)

h)As of September 30, 2013 and December 31, 2012, the Company had restricted assets totaling $5.8 billion and $1.4 billion, respectively. Restricted assets held in trust or on deposit for the benefit of policyholders or ceding companies or to support underwriting activities were $5.1 billion and $1.3 billion as of September 30, 2013 and December 31, 2012, respectively, of which $3.6 billion at September 30, 2013 is attributable to Alterra. Additionally, the Company had pledged investments and cash and cash equivalents totaling $706.8 million and $23.2 million as of September 30, 2013 and December 31, 2012, respectively, as security for letters of credit that have been issued by various banks on behalf of the Company, of which $671.0 million at September 30, 2013 is attributable to Alterra.

Total restricted assets are included on the Company's consolidated balance sheets as follows.

(dollars in thousands)	September 30, 2013	December 31, 2012
Investments, available-for-sale	$5,121,181	$1,262,755
Restricted cash and cash equivalents	600,171	109,415
Other assets	38,435	—
Total	$5,759,787	$1,372,170

5. Fair Value Measurements

FASB ASC 820-10, Fair Value Measurements and Disclosures, establishes a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the assets or liabilities fall within different levels of the hierarchy, the classification is based on the lowest level input that is significant to the fair value measurement of the asset or liability.

Classification of assets and liabilities within the hierarchy considers the markets in which the assets and liabilities are traded and the reliability and transparency of the assumptions used to determine fair value. The hierarchy requires the use of observable market data when available. The levels of the hierarchy are defined as follows:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities traded in active markets.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and market-corroborated inputs.

Level 3 – Inputs to the valuation methodology are unobservable for the asset or liability and are significant to the fair value measurement.

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In accordance with FASB ASC 820, the Company determines fair value based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods, including the market, income and cost approaches. The Company uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The following section describes the valuation methodologies used by the Company to measure assets and liabilities at fair value, including an indication of the level within the fair value hierarchy in which each asset or liability is generally classified.

Investments available-for-sale. Investments available-for-sale are recorded at fair value on a recurring basis and include fixed maturities, equity securities and short-term investments. Short-term investments include certificates of deposit, commercial paper, discount notes and treasury bills with original maturities of one year or less. Fair value for investments available-for-sale is determined by the Company after considering various sources of information, including information provided by a third party pricing service. The pricing service provides prices for substantially all of the Company's fixed maturities and equity securities. In determining fair value, the Company generally does not adjust the prices obtained from the pricing service. The Company obtains an understanding of the pricing service's valuation methodologies and related inputs, which include, but are not limited to, reported trades, benchmark yields, issuer spreads, bids, offers, duration, credit ratings, estimated cash flows and prepayment speeds. The Company validates prices provided by the pricing service by reviewing prices from other pricing sources and analyzing pricing data in certain instances.

The Company has evaluated the various types of securities in its investment portfolio to determine an appropriate fair value hierarchy level based upon trading activity and the observability of market inputs. Level 1 investments include those traded on an active exchange, such as the New York Stock Exchange. Level 2 investments include U.S. Treasury securities and obligations of U.S. government agencies, municipal bonds, foreign government bonds, residential mortgage-backed securities and corporate debt securities.

Fair value for investments available-for-sale is measured based upon quoted prices in active markets, if available. Due to variations in trading volumes and the lack of quoted market prices, fixed maturities are classified as Level 2 investments. The fair value of fixed maturities is normally derived through recent reported trades for identical or similar securities, making adjustments through the reporting date based upon available market observable data described above. If there are no recent reported trades, the fair value of fixed maturities may be derived through the use of matrix pricing or model processes, where future cash flow expectations are developed based upon collateral performance and discounted at an estimated market rate. Significant inputs used to determine the fair value of obligations of states, municipalities and political subdivisions, corporate bonds and obligations of foreign governments include reported trades, benchmark yields, issuer spreads, bids, offers, credit information and estimated cash flows. Significant inputs used to determine the fair value of residential mortgage-backed securities include the type of underlying mortgage loans, benchmark yields, prepayment speeds, collateral information, tranche type and volatility, estimated cash flows, credit information, default rates, recovery rates, issuer spreads and the year of issue.

Derivatives. Derivatives are recorded at fair value on a recurring basis and include a credit default swap. The fair value of the credit default swap is measured by the Company using an external valuation model. See note 10 for a discussion of the valuation model for the credit default swap, including the key inputs and assumptions used in the model and a description of the valuation processes used by the Company. Due to the significance of unobservable inputs required in measuring the fair value of the credit default swap, the credit default swap has been classified as Level 3 within the fair value hierarchy.

Senior long-term debt and other debt. Senior long-term debt and other debt is carried at amortized cost with the estimated fair value disclosed on the consolidated balance sheets. Senior long-term debt and other debt is classified as

Level 2 within the fair value hierarchy due to variations in trading volumes and the lack of quoted market prices. Fair value for senior long-term debt and other debt is generally derived through recent reported trades for identical securities, making adjustments through the reporting date, if necessary, based upon available market observable data including U.S. Treasury securities and implied credit spreads. Significant inputs used to determine the fair value of senior long-term debt and other debt include reported trades, benchmark yields, issuer spreads, bids and offers.

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The following tables present the balances of assets and liabilities measured at fair value on a recurring basis by level within the fair value hierarchy.

	September 30, 2013			
(dollars in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Investments available-for-sale:				
Fixed maturities:				
U.S. Treasury securities and obligations of U.S. government agencies	$—	$1,244,128	$—	$1,244,128
Obligations of states, municipalities and political subdivisions	—	2,851,061	—	2,851,061
Foreign governments	—	1,423,684	—	1,423,684
Commercial mortgage-backed securities	—	390,709	—	390,709
Residential mortgage-backed securities	—	925,974	—	925,974
Asset-backed securities	—	215,876	—	215,876
Corporate bonds	—	3,261,507	—	3,261,507
Total fixed maturities	—	10,312,939	—	10,312,939
Equity securities:				
Insurance, banks and other financial institutions	945,431	—	—	945,431
Industrial, consumer and all other	2,043,183	—	—	2,043,183
Total equity securities	2,988,614	—	—	2,988,614
Short-term investments	1,016,185	143,272	—	1,159,457
Total investments available-for-sale	$4,004,799	$10,456,211	$—	$14,461,010
Liabilities:				
Derivative contracts	$—	$—	$3,830	$3,830

	December 31, 2012			
(dollars in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Investments available-for-sale:				
Fixed maturities:				
U.S. Treasury securities and obligations of U.S. government agencies	$—	$317,507	$—	$317,507
Obligations of states, municipalities and political subdivisions	—	2,831,562	—	2,831,562
Foreign governments	—	556,608	—	556,608
Residential mortgage-backed securities	—	215,377	—	215,377
Asset-backed securities	—	14,345	—	14,345
Corporate bonds	—	1,043,884	—	1,043,884
Total fixed maturities	—	4,979,283	—	4,979,283
Equity securities:				
Insurance, banks and other financial institutions	898,067	—	—	898,067
Industrial, consumer and all other	1,508,884	—	—	1,508,884
Total equity securities	2,406,951	—	—	2,406,951
Short-term investments	888,758	84,572	—	973,330
Total investments available-for-sale	$3,295,709	$5,063,855	$—	$8,359,564
Liabilities:				
Derivative contracts	$—	$—	$12,690	$12,690

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The following table summarizes changes in Level 3 liabilities measured at fair value on a recurring basis.

	Quarter Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	2013	2012	2013	2012
Derivatives, beginning of period	$5,490	$17,130	$12,690	$29,331
Total gains included in:				
Net income	(1,660)	(1,480)	(8,860)	(13,681)
Other comprehensive income	—	—	—	—
Transfers into Level 3	—	—	—	—
Transfers out of Level 3	—	—	—	—
Derivatives, end of period	$3,830	$15,650	$3,830	$15,650
Net unrealized gains included in net income relating to liabilities held at September 30, 2013 and 2012 [1]	$1,660	$1,480	$8,860	$13,681

[1] Included in net investment income in the consolidated statements of income and comprehensive income.

There were no transfers into or out of Level 1 and Level 2 during the quarter and nine months ended September 30, 2013 and 2012. Except as disclosed in note 3, the Company did not have any assets or liabilities measured at fair value on a non-recurring basis during the nine months ended September 30, 2013 and 2012.

6. Segment Reporting Disclosures

The Company historically operated in three segments of the specialty insurance marketplace: the Excess and Surplus Lines, the Specialty Admitted and the London Insurance Market segments. The Company considers many factors, including the nature of its insurance products, production sources, distribution strategies and regulatory environment in determining how to aggregate operating segments.

As a result of the acquisition of Alterra, the Company formed a new operating segment, effective May 1, 2013. The Alterra segment is comprised of all of the active property and casualty underwriting operations of the former Alterra companies. The Alterra segment provides specialty insurance and reinsurance products worldwide from offices in the United States, Bermuda, the United Kingdom, Europe and Latin America. Results attributable to Alterra are being separately evaluated by management. The Company is in the process of integrating Alterra with its existing operations, which is not expected to be complete until 2014.

For purposes of segment reporting, the Other Insurance (Discontinued Lines) segment includes lines of business that have been discontinued in conjunction with acquisitions. Prior to its acquisition by the Company, Alterra offered life and annuity reinsurance products. In 2010, Alterra ceased writing life and annuity reinsurance contracts and placed this business into run-off. Results attributable to the run-off of Alterra's life and annuity reinsurance business are included in the Company's Other Insurance (Discontinued Lines) segment.

All investing activities related to our insurance operations are included in the Investing segment.

The Company's non-insurance operations primarily consist of controlling interests in various industrial and service businesses. For purposes of segment reporting, the Company's non-insurance operations are not considered to be a reportable operating segment.

Segment profit for the Investing segment is measured by net investment income and net realized investment gains or losses. Segment profit or loss for the Company's operating segments is primarily measured by underwriting profit or loss. The property and casualty insurance industry commonly defines underwriting profit or loss as earned premiums net of losses and loss adjustment expenses and underwriting, acquisition and insurance expenses. Underwriting profit or loss does not replace operating income or net income computed in accordance with U.S. GAAP as a measure of profitability. Underwriting profit or loss provides a basis for management to evaluate the Company's underwriting performance. Segment profit or loss for the Company's operating segments also includes other revenues and other expenses, primarily related to the run-off of managing general agent operations that were discontinued in conjunction with acquisitions. Other revenues and other expenses in the Other Insurance (Discontinued Lines) segment are comprised of the results attributable to the run-off of Alterra's life and annuity reinsurance business.

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For management reporting purposes, the Company allocates assets to its underwriting, investing and non-insurance operations. Underwriting assets are all assets not specifically allocated to the Investing segment or to the Company's non-insurance operations. Underwriting and investing assets are not allocated to the Excess and Surplus Lines, Specialty Admitted, London Insurance Market, Alterra or Other Insurance (Discontinued Lines) segments since the Company does not manage its assets by operating segment. The Company does not allocate capital expenditures for long-lived assets to any of its operating segments for management reporting purposes.

a) The following tables summarize the Company's segment disclosures.

	Quarter Ended September 30, 2013						
(dollars in thousands)	Excess and Surplus Lines	Specialty Admitted	London Insurance Market	Alterra	Other Insurance (Discontinued Lines)	Investing	Consolidated
Gross premium volume	$273,757	$230,450	$199,575	$372,516	$ —	$—	$1,076,298
Net written premiums	232,396	219,955	174,203	216,378	(1)	—	842,931
Earned premiums	218,538	197,372	199,633	304,181	(1)	—	919,723
Losses and loss adjustment expenses:							
Current accident year	(147,204)	(126,649)	(135,098)	(201,732)	—	—	(610,683)
Prior accident years	40,799	28,410	40,562	—	(32,460)	—	77,311
Underwriting, acquisition and insurance expenses:							
Transaction costs and other acquisition-related expenses [1]	—	—	—	(8,508)	—	—	(8,508)
All other expenses	(85,570)	(80,023)	(73,335)	(104,608)	(82)	—	(343,618)
Underwriting profit (loss)	26,563	19,110	31,762	(10,667)	(32,543)	—	34,225
Net investment income	—	—	—	—	—	86,192	86,192
Net realized investment gains	—	—	—	—	—	11,238	11,238
Other revenues (insurance)	—	1,402	311	59	160	—	1,932
Other expenses (insurance)	—	(6,292)	(1,167)	—	(8,789)	—	(16,248)
Segment profit (loss)	$26,563	$14,220	$30,906	$(10,608)	$ (41,172)	$97,430	$117,339
Other revenues (non-insurance)							172,580
Other expenses (non-insurance)							(150,318)
Amortization of intangible assets							(16,848)
Interest expense							(30,619)

Income before income taxes											$92,134	
U.S. GAAP combined ratio [2]	88	%	90	%	84	%	104	%	NM	[3]	96	%

(1) In connection with the acquisition of Alterra, the Company incurred acquisition-related costs totaling $8.5 million for the quarter ended September 30, 2013, which included severance costs of $3.5 million, stay bonuses of $3.9 million and other compensation costs of $1.1 million related to the acceleration of certain long-term incentive compensation awards and restricted stock awards that were granted by Alterra prior to the acquisition.

(2) The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

(3) NM – Ratio is not meaningful.

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(dollars in thousands)	Quarter Ended September 30, 2012 Excess and Surplus Lines	Specialty Admitted	London Insurance Market	Other Insurance (Discontinued Lines)	Investing	Consolidated
Gross premium volume	$253,014	$167,747	$190,071	$ 1	$—	$610,833
Net written premiums	211,538	157,894	170,193	(1)	—	539,624
Earned premiums	195,478	153,009	182,052	(2)	—	530,537
Losses and loss adjustment expenses:						
Current accident year	(134,504)	(116,044)	(122,192)	—	—	(372,740)
Prior accident years	51,310	11,504	32,744	(26,277)	—	69,281
Underwriting, acquisition and insurance expenses:						
Prospective adoption of ASU 2010-26 (1)	(2,125)	(2,600)	(1,809)	—	—	(6,534)
All other expenses	(88,093)	(60,008)	(76,820)	(386)	—	(225,307)
Underwriting profit (loss)	22,066	(14,139)	13,975	(26,665)	—	(4,763)
Net investment income	—	—	—	—	64,438	64,438
Net realized investment gains	—	—	—	—	5,231	5,231
Other revenues (insurance)	—	11,536	223	—	—	11,759
Other expenses (insurance)	—	(12,181)	(970)	—	—	(13,151)
Segment profit (loss)	$22,066	$(14,784)	$13,228	$ (26,665)	$69,669	$63,514
Other revenues (non-insurance)						153,810
Other expenses (non-insurance)						(132,188)
Amortization of intangible assets						(7,959)
Interest expense						(24,692)
Income before income taxes						$52,485
U.S. GAAP combined ratio (2)	89%	109%	92%	NM (3)		101%

(1) Effective January 1, 2012, the Company prospectively adopted FASB ASU No. 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. At December 31, 2011, deferred policy acquisition costs included $43.1 million of costs that no longer met the criteria for deferral as of January 1, 2012 and were recognized into income during 2012, consistent with policy terms. The quarter ended September 30, 2012 included $6.5 million of underwriting, acquisition and insurance expenses that were deferred as of December 31, 2011 and no longer met the criteria for deferral as of January 1, 2012.

(2) The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

(3) NM – Ratio is not meaningful.

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(dollars in thousands)	Excess and Surplus Lines	Specialty Admitted	London Insurance Market	Alterra	Other Insurance (Discontinued Lines)	Investing	Consolidated
	Nine Months Ended September 30, 2013						
Gross premium volume	$792,877	$687,669	$725,153	$714,844	$ 35	$—	$2,920,578
Net written premiums	673,741	655,350	634,180	469,894	35	—	2,433,200
Earned premiums	629,288	533,037	577,101	529,668	35	—	2,269,129
Losses and loss adjustment expenses:							
Current accident year	(424,398)	(353,581)	(386,617)	(380,513)	—	—	(1,545,109)
Prior accident years	165,587	45,863	101,589	—	(31,604)	—	281,435
Underwriting, acquisition and insurance expenses:							
Transaction costs and other acquisition-related expenses [1]	—	—	—	(70,317)	—	—	(70,317)
All other expenses	(250,101)	(229,462)	(222,469)	(171,762)	217	—	(873,577)
Underwriting profit (loss)	120,376	(4,143)	69,604	(92,924)	(31,352)	—	61,561
Net investment income	—	—	—	—	—	228,788	228,788
Net realized investment gains	—	—	—	—	—	40,701	40,701
Other revenues (insurance)	—	11,945	4,778	1,256	479	—	18,458
Other expenses (insurance)	—	(14,447)	(3,762)	—	(13,039)	—	(31,248)
Segment profit (loss)	$120,376	$(6,645)	$70,620	$(91,668)	$ (43,912)	$269,489	$318,260
Other revenues (non-insurance)							486,222
Other expenses (non-insurance)							(428,394)
Amortization of intangible assets							(37,755)
Interest expense							(82,754)
Income before income taxes							$255,579
U.S. GAAP combined ratio [2]	81%	101%	88%	118%	NM [3]		97%

(1) In connection with the acquisition of Alterra, the Company incurred transaction costs of $16.0 million for the nine months ended September 30, 2013, which primarily consist of due diligence, legal and investment banking costs. Additionally, the Company incurred severance costs of $31.7 million, stay bonuses of $10.0 million and other compensation costs totaling $12.6 million related to the acceleration of certain long-term incentive compensation awards and restricted stock awards that were granted by Alterra prior to the acquisition.

(2) The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

(3) NM – Ratio is not meaningful.

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	Nine Months Ended September 30, 2012					
(dollars in thousands)	Excess and Surplus Lines	Specialty Admitted	London Insurance Market	Other Insurance (Discontinued Lines)	Investing	Consolidated
Gross premium volume	$705,849	$496,019	$704,511	$ (6)	$—	$1,906,373
Net written premiums	597,742	467,722	621,947	(7)	—	1,687,404
Earned premiums	584,524	431,179	557,493	(7)	—	1,573,189
Losses and loss adjustment expenses:						
Current accident year	(390,254)	(310,115)	(372,869)	—	—	(1,073,238)
Prior accident years	132,583	27,747	118,994	(19,160)	—	260,164
Underwriting, acquisition and insurance expenses:						
Prospective adoption of ASU 2010-26 (1)	(16,652)	(12,863)	(11,578)	—	—	(41,093)
All other expenses	(255,295)	(171,111)	(226,770)	(1,053)	—	(654,229)
Underwriting profit (loss)	54,906	(35,163)	65,270	(20,220)	—	64,793
Net investment income	—	—	—	—	207,834	207,834
Net realized investment gains	—	—	—	—	25,356	25,356
Other revenues (insurance)	—	36,065	4,753	—	—	40,818
Other expenses (insurance)	—	(35,184)	(2,722)	—	—	(37,906)
Segment profit (loss)	$54,906	$(34,282)	$67,301	$ (20,220)	$233,190	$300,895
Other revenues (non-insurance)						344,960
Other expenses (non-insurance)						(305,556)
Amortization of intangible assets						(25,078)
Interest expense						(69,068)
Income before income taxes						$246,153
U.S. GAAP combined ratio (2)	91 %	108 %	88 %	NM (3)		96 %

(1) Effective January 1, 2012, the Company prospectively adopted FASB ASU No. 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. At December 31, 2011, deferred policy acquisition costs included $43.1 million of costs that no longer met the criteria for deferral as of January 1, 2012 and were recognized into income during 2012, consistent with policy terms. The nine months ended September 30, 2012 included $41.1 million of underwriting, acquisition and insurance expenses that were deferred as of December 31, 2011 and no longer met the criteria for deferral as of January 1, 2012.

(2) The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

(3) NM – Ratio is not meaningful.

b) The following table reconciles segment assets to the Company's consolidated balance sheets.

(dollars in thousands)	September 30, 2013	December 31, 2012
Segment assets:		
Investing	$17,125,848	$9,277,697
Underwriting	5,778,934	2,387,305
Total segment assets	22,904,782	11,665,002

Non-insurance operations	903,795	891,586
Total assets	$23,808,577	$12,556,588

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7. Reinsurance

The following tables summarize the effect of reinsurance on premiums written and earned.

	Quarter Ended September 30,			
	2013		2012	
(dollars in thousands)	Written	Earned	Written	Earned
Direct	$836,117	$818,854	$519,408	$505,514
Assumed	240,181	331,495	91,425	94,822
Ceded	(233,367)	(230,626)	(71,209)	(69,799)
Net premiums	$842,931	$919,723	$539,624	$530,537

	Nine Months Ended September 30,			
	2013		2012	
(dollars in thousands)	Written	Earned	Written	Earned
Direct	$2,310,966	$2,076,682	$1,568,092	$1,505,710
Assumed	609,612	675,286	338,281	269,771
Ceded	(487,378)	(482,839)	(218,969)	(202,292)
Net premiums	$2,433,200	$2,269,129	$1,687,404	$1,573,189

The percentage of ceded earned premiums to gross earned premiums was 20% and 12%, respectively, for the quarters ended September 30, 2013 and 2012 and 18% and 11%, respectively, for the nine months ended September 30, 2013 and 2012.

The Company uses reinsurance to manage its net retention on individual risks and overall exposure to losses while providing it with the ability to offer policies with sufficient limits to meet policyholder needs. In a reinsurance transaction, an insurance company transfers, or cedes, all or part of its exposure in return for a portion of the premium. The ceding of insurance does not legally discharge the Company from its primary liability for the full amount of the policies, and the Company will be required to pay the loss and bear collection risk if the reinsurer fails to meet its obligations under the reinsurance agreement.

A credit risk exists with reinsurance ceded to the extent that any reinsurer is unable to meet the obligations assumed under the reinsurance agreements. Allowances are established for amounts deemed uncollectible. The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from its exposure to individual reinsurers. At September 30, 2013 and December 31, 2012, balances recoverable from the Company's ten largest reinsurers, by group, represented approximately 61% and 74%, respectively, of the reinsurance recoverable on paid and unpaid losses, before considering reinsurance allowances. At September 30, 2013, the Company's largest reinsurance balance was due from Fairfax Financial Group and represented 10% of the reinsurance recoverable on paid and unpaid losses, before considering reinsurance allowances.

Incurred losses and loss adjustment expenses were net of reinsurance recoverables (ceded incurred losses and loss adjustment expenses) of $98.0 million and $15.3 million, respectively, for the quarters ended September 30, 2013 and 2012 and $179.9 million and $79.6 million, respectively, for the nine months ended September 30, 2013 and 2012.

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8. Life and Annuity Benefits

Prior to its acquisition by the Company, Alterra entered into long duration reinsurance contracts which subject the Company to mortality, longevity and morbidity risks. The Company's related life and annuity reinsurance benefit reserves are compiled on a reinsurance contract-by-contract basis and are discounted using standard actuarial techniques and cash flow models. Since the development of the life and annuity reinsurance reserves is based upon cash flow projection models, the Company must make estimates and assumptions based on cedant experience and industry mortality tables, longevity, expense and investment experience, including a provision for adverse deviation. The assumptions used to determine policy benefit reserves were determined at the Acquisition Date and are generally locked-in for the life of the contract unless a premium deficiency develops or another unlocking event occurs. As the experience on the reinsurance contracts emerges, the assumptions are reviewed by management, no less than annually, to determine whether the actual and anticipated experience indicates that existing policy reserves, together with the present value of future gross premiums and expected investment income earned thereon, are sufficient to cover the present value of future benefits, settlement and maintenance costs. If such a review produces reserves in excess of those currently held, then the lock-in assumptions are revised and a charge to earnings for life and annuity benefits is recognized at that time. Results attributable to the run-off of Alterra's life and annuity reinsurance business are included in other revenues and other expenses in the Company's consolidated statements of income and comprehensive income and as part of the Company's Other Insurance (Discontinued Lines) segment.

Because of the many assumptions and estimates used in establishing reserves and the long-term nature of reinsurance contracts, the reserving process, while based on actuarial science, is inherently uncertain. Actual results could differ materially from these estimates. The average discount rate for the life and annuity benefit reserves was 2.3% as of September 30, 2013.

The following table presents life and annuity benefits as of September 30, 2013:

	(dollars in thousands)
Life	$189,792
Annuities	1,188,914
Accident and health	104,292
	$1,482,998

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9. Senior Long-Term Debt and Other Debt

The following table summarizes the Company's senior long-term debt and other debt.

(dollars in thousands)	September 30, 2013	December 31, 2012
6.80% unsecured senior notes, due February 15, 2013, interest payable semi-annually, net of unamortized discount of $45 in 2012	$—	$246,619
7.20% unsecured senior notes, due April 14, 2017, interest payable semi-annually, net of unamortized premium of $5,160 in 2013	95,789	—
7.125% unsecured senior notes, due September 30, 2019, interest payable semi-annually, net of unamortized discount of $1,697 in 2013 and $1,909 in 2012	348,303	348,091
6.25% unsecured senior notes, due September 30, 2020, interest payable semi-annually, net of unamortized premium of $64,049 in 2013	414,049	—
5.35% unsecured senior notes, due June 1, 2021, interest payable semi-annually, net of unamortized discount of $1,583 in 2013 and $1,738 in 2012	248,417	248,262
4.90% unsecured senior notes, due July 1, 2022, interest payable semi-annually, net of unamortized discount of $2,444 in 2013 and $2,653 in 2012	347,556	347,347
3.625% unsecured senior notes, due March 30, 2023, interest payable semi-annually, net of unamortized discount of $1,910 in 2013	248,090	—
7.35% unsecured senior notes, due August 15, 2034, interest payable semi-annually, net of unamortized discount of $2,211 in 2013 and $2,291 in 2012	197,789	197,710
5.0% unsecured senior notes, due March 30, 2043, interest payable semi-annually, net of unamortized discount of $6,607 in 2013	243,393	—
Other debt, at various interest rates ranging from 1.6% to 6.5%	107,093	104,521
Senior long-term debt and other debt	$2,250,479	$1,492,550

On July 2, 2012, the Company issued $350 million of 4.90% unsecured senior notes due July 1, 2022. Net proceeds to the Company were $347.2 million. On August 1, 2012, the Company used a portion of these proceeds to redeem its 7.50% unsecured senior debentures due August 22, 2046 at a redemption price equal to 100% of their principal amount, or $150 million. This redemption resulted in a loss of $4.1 million, which is reflected in net realized investment gains. The proceeds from the July 2012 issuance were also used to pre-fund the repayment of the Company's 6.80% unsecured senior notes due February 15, 2013.

On February 15, 2013, the Company repaid its 6.80% unsecured senior notes ($246.7 million principal amount outstanding at December 31, 2012).

On March 8, 2013, the Company issued $250 million of 3.625% unsecured senior notes due March 30, 2023 and $250 million of 5.0% unsecured senior notes due March 30, 2043. Net proceeds to the Company were approximately $491.2 million, to be used for general corporate purposes.

On April 16, 2007, Alterra USA Holdings Limited (Alterra USA), a wholly-owned indirect subsidiary of Alterra, privately issued $100 million of 7.20% unsecured senior notes due April 14, 2017 (the 7.20% unsecured senior notes). The 7.20% unsecured senior notes are Alterra USA's senior unsecured obligations and rank equally in right of payment with all existing and future senior unsecured indebtedness of Alterra USA. The 7.20% unsecured senior notes are fully and unconditionally guaranteed by Alterra. The principal amount of the 7.20% unsecured senior notes outstanding as of the Acquisition Date was $90.6 million. As of the Acquisition Date, the 7.20% unsecured senior notes were recorded at their estimated fair value of $95.8 million.

On September 27, 2010, Alterra Finance LLC, a wholly-owned indirect subsidiary of Alterra, issued $350 million of 6.25% unsecured senior notes due September 30, 2020 (the 6.25% unsecured senior notes). The 6.25% unsecured senior notes are Alterra Finance LLC's senior unsecured obligations and rank equally in right of payment with all of Alterra Finance LLC's future unsecured and unsubordinated indebtedness and rank senior to all of Alterra Finance LLC's future subordinated indebtedness. The 6.25% unsecured senior notes are fully and unconditionally guaranteed by Alterra on a senior unsecured basis. The guarantee ranks equally with all of Alterra's existing and future unsecured and unsubordinated indebtedness and ranks senior to all of Alterra's future subordinated indebtedness. As of the Acquisition Date, the 6.25% unsecured senior notes were recorded at their estimated fair value of $416.6 million.

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Alterra Finance LLC is a finance subsidiary and has no independent activities, assets or operations other than in connection with the 6.25% unsecured senior notes.

The Company's 7.35% unsecured senior notes due August 15, 2034 are not redeemable. The Company's other unsecured senior notes are redeemable by the Company at any time, subject to payment of a make-whole premium to the noteholders. None of the Company's senior long-term debt is subject to any sinking fund requirements.

The Company's other debt is primarily associated with its non-insurance operations and is non-recourse to the holding company. The debt of the Company's non-insurance subsidiaries generally is secured by the assets of those subsidiaries. ParkLand Ventures, Inc., a subsidiary of the Company, has formed subsidiaries for the purpose of acquiring and financing real estate (the real estate subsidiaries). The assets of the real estate subsidiaries, which are not material to the Company, are consolidated in accordance with U.S. GAAP but are not available to satisfy the debt and other obligations of the Company or any affiliates other than the real estate subsidiaries.

The following table summarizes the future principal payments due at maturity on senior long-term debt and other debt as of September 30, 2013.

Years Ending December 31,	(dollars in thousands)
2013	$4,498
2014	17,857
2015	5,090
2016	12,092
2017	104,366
2018 and thereafter	2,053,819
Total principal payments	$2,197,722
Net unamortized premium	52,757
Senior long-term debt and other debt	$2,250,479

The Company also maintains a revolving credit facility for working capital and other general corporate purposes that expires September 2015. Effective July 12, 2013, the capacity of the Company's revolving credit facility was increased from $150 million to $300 million, as previously provided for by the terms of the revolving credit facility. The Company may select from two interest rate options for balances outstanding under the revolving credit facility and pays a commitment fee (0.25% at September 30, 2013) on the unused portion of the facility based on the Company's debt to equity leverage ratio as calculated under the agreement. At September 30, 2013 and December 31, 2012, the Company had no borrowings outstanding under the revolving credit facility.

Alterra and Markel Bermuda are party to a $900 million secured credit facility (the senior credit facility), which expires on December 15, 2015. The senior credit facility provides for secured letters of credit to be issued for the account of Alterra, Markel Bermuda and certain other subsidiaries of Alterra and for loans to Alterra and Markel Bermuda. Loans under the senior credit facility are subject to a sublimit of $250 million. Subject to certain conditions and at the request of Alterra, the aggregate commitments of the lenders under the senior credit facility may be increased up to a total of $1.4 billion. At September 30, 2013, the Company had no borrowings outstanding under the senior credit facility. At September 30, 2013, $439.6 million of letters of credit were issued and outstanding under the senior credit facility.

At September 30, 2013, the Company was in compliance with all covenants contained in its revolving credit facility and senior credit facility. To the extent that the Company is not in compliance with its covenants, the Company's access to these credit facilities could be restricted. While the Company believes this to be unlikely, the inability to access the revolving credit facility and senior credit facility could adversely affect the Company's liquidity.

10. Derivatives

The Company is a party to a credit default swap agreement, under which third party credit risk is transferred from a counterparty to the Company. The Company entered into the credit default swap agreement for investment purposes. At both September 30, 2013 and December 31, 2012, the notional amount of the credit default swap was $33.1 million, which represented the Company's aggregate exposure to losses if specified credit events involving third party reference entities occur. These third party reference entities are specified under the terms of the agreement and represent a portfolio of names upon which the Company has assumed credit risk from the counterparty. The Company's exposure to loss from any one reference entity is limited to $20.0 million. The credit default swap has a scheduled termination date of December 2014.

The credit default swap is accounted for as a derivative instrument and is recorded at fair value with any changes in fair value recorded in net investment income. At September 30, 2013 and December 31, 2012, the credit default swap had a fair value of $3.8 million and $12.7 million, respectively. The fair value of the credit default swap is included in other liabilities on the consolidated balance sheets. Net investment income for the quarter and nine months ended September 30, 2013 included favorable changes in the fair value of the credit default swap of $1.7 million and $8.9 million, respectively. Net investment income for the quarter and nine months ended September 30, 2012 included favorable changes in the fair value of the credit default swap of $1.5 million and $13.7 million, respectively.

The fair value of the credit default swap is determined by the Company using a Gaussian copula valuation model, a market standard model for valuing credit default swaps. The fair value is dependent upon several inputs, including changes in interest rates, credit spreads, expected default rates, changes in credit quality, future expected recovery rates and other market factors. The significant unobservable inputs used in the fair value measurement of the credit default swap are expected default rates and future expected recovery rates. The Company determines these unobservable inputs based upon default rates and recovery rates used to price similar credit default swap indices. A significant increase in expected default rates in isolation results in a significantly higher fair value measurement, while a significant decrease in expected default rates results in a significantly lower fair value measurement. A significant increase in future expected recovery rates in isolation results in a significantly lower fair value measurement, while a significant decrease in future expected recovery rates results in a significantly higher fair value measurement. Generally, a change in the assumption used for expected default rates is accompanied by a directionally opposite change in future expected recovery rates. The fair value measurement of the credit default swap at September 30, 2013 included expected default rates ranging between less than 1% and 10%, with a weighted-average expected default rate of 1%, and future expected recovery rates ranging between 20% and 40%, with a weighted-average future expected recovery rate of 39%. The fair value measurement of the credit default swap at December 31, 2012 included expected default rates ranging between 1% and 43%, with a weighted-average expected default rate of 3%, and future expected recovery rates ranging between 20% and 40%, with a weighted-average future expected recovery rate of 39%.

The Company's valuation policies and procedures for the credit default swap are determined by an internal investment manager with oversight provided by the Company's Chief Financial Officer and Chief Investment Officer. Fair value measurements are analyzed quarterly to ensure the change in fair value from prior periods is reasonable relative to recent market trends. Additionally, the reported fair value of the credit default swap is compared to results from similar valuation models.

The Company had no other material derivative instruments at September 30, 2013.

11. Income Taxes

The Company's effective tax rate was 28% for the nine months ended September 30, 2013 compared to 19% for the same period in 2012. In both periods, the effective tax rate differs from the statutory tax rate of 35% primarily as a result of tax-exempt investment income. The increase in the effective tax rate in 2013 was primarily due to higher estimated earnings taxed at a 35% tax rate and anticipating a smaller tax benefit related to tax-exempt investment income, which resulted from having higher estimated income before income taxes in 2013 compared to 2012.

12. Employee Benefit Plans

a)Expenses relating to the Company's defined contribution plans, including the defined contribution plans of Alterra effective May 1, 2013, were $6.2 million and $16.7 million, respectively, for the quarter and nine months ended September 30, 2013 and $4.6 million and $13.9 million, respectively, for the same periods of 2012.

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b)The following table presents the components of net periodic benefit income for the Terra Nova Pension Plan, a defined benefit plan.

	Quarter Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	2013	2012	2013	2012
Service cost	$—	$90	$—	$269
Interest cost	1,611	1,693	4,837	5,079
Expected return on plan assets	(2,671)	(2,432)	(8,015)	(7,295)
Amortization of net actuarial pension loss	477	643	1,432	1,930
Net periodic benefit income	$(583)	$(6)	$(1,746)	$(17)

The Company contributed $5.3 million to the Terra Nova Pension Plan during the nine months ended September 30, 2013 and does not expect to make any additional contributions in 2013.

13. Shareholders' Equity

a) Net income per share was determined by dividing adjusted net income to shareholders by the applicable weighted average shares outstanding. Unvested share-based compensation awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are considered participating awards and are included in the computation of net income per share. Non-participating unvested share-based compensation awards are excluded from the computation of net income per share. Diluted net income per share is computed by dividing adjusted net income to shareholders by the weighted average number of common shares and dilutive potential common shares outstanding during the year.

	Quarter Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share amounts)	2013	2012	2013	2012
Net income to shareholders	$65,599	$49,653	$182,257	$196,593
Adjustment of redeemable noncontrolling interests	—	1,702	3,101	(6,484)
Adjusted net income to shareholders	$65,599	$51,355	$185,358	$190,109
Basic common shares outstanding	14,001	9,632	12,050	9,641
Dilutive potential common shares from conversion of options	16	4	11	7
Dilutive potential common shares from conversion of non participating restricted stock	39	23	32	19
Diluted shares outstanding	14,056	9,659	12,093	9,667
Basic net income per share	$4.69	$5.33	$15.38	$19.72
Diluted net income per share	$4.67	$5.32	$15.33	$19.67

b) The 2012 Equity Incentive Compensation Plan (2012 Compensation Plan) provides for grants and awards of restricted stock, restricted stock units, performance grants, and other stock based awards to employees and directors. The 2012 Compensation Plan is administered by the Compensation Committee of the Company's Board of Directors (Compensation Committee). In May 2013, the Compensation Committee awarded 31,669 restricted stock units to certain associates and executive officers to assist the Company in retaining the services of key employees. The restricted stock units had a grant-date fair value of $16.6 million. The awards vest over a three year period and entitle the recipient to receive one share of the Company's common stock for each vested restricted stock unit.

c) In May 2013, in connection with the acquisition of Alterra, the Company issued 101,875 replacement options and 154,103 restricted stock awards to holders of Alterra options and restricted stock awards. The replacement options and restricted stock awards were issued under the terms and conditions of the Alterra Capital Holdings Limited 2008 Stock Incentive Plan, the Alterra Capital Holdings Limited 2006 Equity Incentive Plan and the Alterra Capital Holdings Limited 2000 Stock Incentive Plan (collectively, the Alterra Equity Award Plans). No further options or restricted stock awards are available for issuance under the Alterra Equity Award Plans.

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The replacement options issued were fully vested and exercisable as of the Acquisition Date and had a weighted average exercise price of $398.96 and a grant-date fair value of $140.08, which was included in the acquisition consideration. The fair value of the options was estimated on the grant date using the Black-Scholes option pricing model. Assumptions used in the pricing model included an expected annual volatility of 19.04%, a risk-free rate of approximately 0.20% and an expected term of approximately two years. The expected annual volatility was based on the historical volatility of the Company's stock and other factors. The risk-free rate was based on the U.S. Treasury yield curve, with a remaining term equal to the expected term assumption at the grant date. The expected term of the options granted represents the period of time that the options were expected to be outstanding at the grant date.

The following table summarizes additional information with respect to these options.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Intrinsic Value (in millions)
Outstanding and exercisable, May 1, 2013	101,875	$398.96		
Exercised	49,763	$401.83		
Outstanding and exercisable, September 30, 2013	52,112	$396.22	2.6	$6.7

From the Acquisition Date through September 30, 2013, 49,763 options were exercised under the Alterra Equity Award Plans, resulting in cash proceeds of $18.5 million and a current tax benefit of $0.7 million. The intrinsic value of options exercised in 2013 was $6.4 million.

The replacement restricted stock awards issued by the Company had a grant date fair value of $81.6 million, or $529.59 per share. The awards were partially vested as of the Acquisition Date and had a weighted average remaining service period of approximately one year. As a result, $61.0 million was recognized as part of the Acquisition Consideration and $20.6 million will be recognized as compensation expense over the remaining service period of the awards. The fair value of the replacement restricted stock awards was determined based on the weighted average price of the Company's stock on April 30, 2013, the day preceding the Acquisition Date. The following table summarizes activity related to these nonvested restricted stock awards.

	Number of Awards	Weighted Average Grant-Date Fair Value
Nonvested awards issued on May 1, 2013	154,103	$ 529.59
Vested	(76,287)	529.59
Forfeited	(7,476)	529.59
Nonvested awards at September 30, 2013	70,340	$ 529.59

The Company recognized compensation expense totaling $1.5 million and $10.9 million, respectively, during the quarter and nine months ended September 30, 2013 related to these restricted stock awards. As of September 30, 2013, unrecognized compensation cost related to the nonvested restricted stock awards was $6.5 million, which is expected to be recognized over a weighted average period of approximately one year. The fair value of the restricted stock awards that vested during 2013 was $40.4 million.

d) In accordance with the terms of the Merger Agreement, the Company also assumed outstanding warrants to purchase Alterra common stock. Holders of the warrants had the option to surrender them for consideration specified in the Merger Agreement, which included cash and registered shares of the Company's common stock, or to have them remain outstanding as "Company Converted Warrants," in which case the holders would be entitled to a combination of cash and unregistered shares of the Company's common stock upon exercise of the warrants. The warrants of all warrant holders who elected to exercise in conjunction with the Acquisition Date were considered to have been exercised on May 1, 2013. The Company issued 225,529 Company Converted Warrants with a fair value of $73.7 million to Alterra warrant holders who elected not to surrender their warrants in connection with the merger. Three holders who elected to have their warrants remain outstanding subsequently exercised a total of 225,499 warrants and received a total of 100,115 shares of the Company's common stock under the cashless exercise provision of the warrants. As of September 30, 2013, the Company had outstanding warrants to purchase 30 shares of its common stock.

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14. Other Comprehensive Income

Other comprehensive income includes net holding gains arising during the period, changes in unrealized other-than-temporary impairment losses on fixed maturities arising during the period and reclassification adjustments for net gains included in net income. Other comprehensive income also includes changes in foreign currency translation adjustments and changes in net actuarial pension loss.

The following table presents the change in accumulated other comprehensive income by component, net of taxes and noncontrolling interests, for the nine months ended September 30, 2013 and 2012.

(dollars in thousands)	Unrealized Holding Gains on Available-for-Sale Securities	Foreign Currency	Net Actuarial Pension Loss	Total
December 31, 2011	$ 704,719	$(2,614)	$(41,185)	$660,920
Other comprehensive income before reclassifications	245,920	2,969	—	248,889
Amounts reclassified from accumulated other comprehensive income	(20,154)	—	1,487	(18,667)
Total other comprehensive income	225,766	2,969	1,487	230,222
September 30, 2012	$ 930,485	$355	$(39,698)	$891,142
December 31, 2012	$ 946,933	$(1,075)	$(34,521)	$911,337
Other comprehensive income before reclassifications	107,433	(9,931)	—	97,502
Amounts reclassified from accumulated other comprehensive income	(27,866)	—	1,146	(26,720)
Total other comprehensive income	79,567	(9,931)	1,146	70,782
September 30, 2013	$ 1,026,500	$(11,006)	$(33,375)	$982,119

The following table summarizes the deferred tax expense (benefit) associated with each component of other comprehensive income.

	Quarter Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	2013	2012	2013	2012
Change in net unrealized gains on investments:				
Net holding gains arising during the period	$35,765	$45,325	$43,840	$113,215
Change in unrealized other-than-temporary impairment losses on fixed maturities arising during the period	(63)	(38)	(9)	(41)
Reclassification adjustments for net gains included in net income	(3,186)	(2,835)	(12,384)	(8,635)
Change in net unrealized gains on investments	32,516	42,452	31,447	104,539
Change in foreign currency translation adjustments	—	(409)	38	(457)
Change in net actuarial pension loss	67	121	286	443
Total	$32,583	$42,164	$31,771	$104,525

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The following table presents the details of amounts reclassified from accumulated other comprehensive income into income, by component.

	Quarter Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	2013	2012	2013	2012
Unrealized holding gains on available-for-sale securities:				
Net realized investment gains	$10,840	$9,319	$40,250	$28,789
Income taxes	(3,186)	(2,835)	(12,384)	(8,635)
Reclassification of unrealized holding gains, net of taxes	$7,654	$6,484	$27,866	$20,154
Net actuarial pension loss:				
Underwriting, acquisition and insurance expenses	$(477)	$(643)	$(1,432)	$(1,930)
Income taxes	67	121	286	443
Reclassification of net actuarial pension loss, net of taxes	$(410)	$(522)	$(1,146)	$(1,487)

15. Commitments and Contingencies

On August 8, 2013, Alterra Holdings Limited, a wholly-owned subsidiary of Alterra, and several other third-party investors, executed a subscription agreement with New Point VI Limited to purchase common shares of New Point VI Limited. As of September 30, 2013, no shares had been issued under the subscription agreement; however, Alterra Holdings Limited's commitment under the subscription agreement with New Point VI Limited is $75.0 million. New Point VI Limited is the holding company of New Point Re VI Limited, a Bermuda-domiciled reinsurance company that will offer fully-collateralized retrocessional reinsurance, incepting between January 1, 2014 and December 31, 2014, to the property reinsurance catastrophe market.

Contingencies arise in the normal course of the Company's operations and are not expected to have a material impact on the Company's financial condition or results of operations.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The accompanying consolidated financial statements and related notes have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include the accounts of Markel Corporation and its subsidiaries.

Critical Accounting Estimates

Critical accounting estimates are those estimates that both are important to the portrayal of our financial condition and results of operations and require us to exercise significant judgment. The preparation of financial statements in accordance with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of material contingent assets and liabilities, including litigation contingencies. These estimates, by necessity, are based on assumptions about numerous factors.

We review our critical accounting estimates and assumptions quarterly. These reviews include evaluating the adequacy of reserves for unpaid losses and loss adjustment expenses, life and annuity reinsurance benefit reserves, the reinsurance allowance for doubtful accounts and income tax liabilities, as well as analyzing the recoverability of deferred tax assets, assessing goodwill and intangible assets for impairment, estimating reinsurance premiums written and evaluating the investment portfolio for other-than-temporary declines in estimated fair value. Actual results may differ materially from the estimates and assumptions used in preparing the consolidated financial statements.

The following discussion should be read in conjunction with our 2012 Annual Report on Form 10-K, which provides a more complete description of our critical accounting estimates.

Reinsurance Premiums

Our reinsurance premiums are recorded at the inception of each contract based upon contract terms and information received from ceding clients and brokers. For excess of loss contracts, the amount of minimum and/or deposit premium is usually contractually documented at inception, and variances between this premium and final premium are generally small. An adjustment is made to the minimum and/or deposit premium, when notified, if there are changes in underlying exposures insured. For quota share or proportional reinsurance contracts, gross premiums written are normally estimated at inception based on information provided by cedants and/or brokers. We generally record such premiums using the client's initial estimates, and then adjust them as more current information becomes available, with such adjustments recorded as premiums written in the period they are determined. We believe that the ceding clients' estimate of the volume of business they expect to cede to us usually represents the best estimate of gross premium written at the beginning of the contract. As the contract progresses, we monitor actual premium received in conjunction with correspondence from the ceding client in order to refine our estimate. Variances from original premium estimates are normally greater for quota share contracts than excess of loss contracts. Premiums are earned on a pro rata basis over the coverage period. The impact of premium adjustments to net income may be mitigated by related acquisition costs and losses.

Life and Annuity Benefits

Prior to its acquisition, Alterra entered into long duration reinsurance contracts which subject us to mortality, longevity and morbidity risks. The related life and annuity reinsurance benefit reserves are compiled by our actuaries on a reinsurance contract-by-contract basis and are computed on a discounted basis using standard actuarial techniques and cash flow models. Since the development of our life and annuity reinsurance reserves is based upon cash flow projection models, we must make estimates and assumptions based on cedant experience and industry mortality tables, longevity, expense and investment experience, including a provision for adverse deviation. The assumptions used to determine policy benefit reserves were determined as of May 1, 2013 (the Acquisition Date) and are generally locked-in for the life of the contract unless a premium deficiency develops or another unlocking event occurs. As the experience on the reinsurance contracts emerges, the assumptions are reviewed by management, no less than annually, to determine whether the actual and anticipated experience indicates that existing policy reserves, together with the present value of future gross premiums and expected investment income earned thereon, are sufficient to cover the present value of future benefits, settlement and maintenance costs. If such a review produces reserves in excess of those currently held, then the lock-in assumptions are revised and a charge for life and annuity benefits is recognized at that time.

Because of the many assumptions and estimates used in establishing reserves and the long-term nature of reinsurance contracts, the reserving process, while based on actuarial science, is inherently uncertain. Actual results could differ materially from these estimates.

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Our Business

We are a diverse financial holding company serving a variety of niche markets. Our principal business markets and underwrites specialty insurance products. We believe that our specialty product focus and niche market strategy enable us to develop expertise and specialized market knowledge. We seek to differentiate ourselves from competitors by our expertise, service, continuity and other value-based considerations. We historically competed in three segments of the specialty insurance marketplace: the Excess and Surplus Lines, the Specialty Admitted and the London Insurance Market segments. As a result of the acquisition of Alterra, we formed a new operating segment during the second quarter of 2013. The Alterra segment comprises all of the active property and casualty underwriting operations of the former Alterra companies. We also own interests in various industrial and service businesses that operate outside of the specialty insurance marketplace. Our financial goals are to earn consistent underwriting and operating profits and superior investment returns to build shareholder value.

Our Excess and Surplus Lines segment writes hard-to-place risks outside of the standard market, including catastrophe-exposed property, professional liability, products liability, general liability, commercial umbrella and other coverages tailored for unique exposures. Our Excess and Surplus Lines segment is comprised of five regions, and each regional office is responsible for serving the wholesale producers located in its region. Our regional teams focus on customer service and marketing, underwriting and distributing our insurance solutions and provide customers easy access to our products.

Our Specialty Admitted segment writes risks that, although unique and hard-to-place in the standard market, must remain with an admitted insurance company for marketing and regulatory reasons. Our underwriting units in this segment write specialty program insurance for well-defined niche markets, personal and commercial property and liability coverages and workers' compensation insurance. Our Specialty Admitted segment is comprised of three underwriting units: Markel Specialty, Markel American Specialty Personal and Commercial Lines and Markel FirstComp. In January 2012, we acquired Thompson Insurance Enterprises, LLC (Thomco), a privately held program administrator that underwrites multi-line, industry-focused insurance programs that complement the Markel Specialty product offerings. Examples include social service organizations, senior living, childcare and fitness centers. In January 2013, we acquired Essentia Insurance Company, a company that underwrites insurance exclusively for Hagerty Insurance Agency and Hagerty Classic Marine Insurance Agency (collectively, Hagerty) throughout the United States. Hagerty offers insurance for classic cars, vintage boats, motorcycles and related automotive collectibles. Results attributable to these acquisitions are included in the Specialty Admitted segment.

Our London Insurance Market segment writes specialty property, casualty, professional liability, equine, marine, energy and trade credit insurance and reinsurance on a worldwide basis. We participate in the London market through Markel International, which includes Markel Capital Limited and Markel International Insurance Company Limited, wholly-owned subsidiaries. Markel Capital Limited is the corporate capital provider for Markel Syndicate 3000 at Lloyd's, which is managed by Markel Syndicate Management Limited, a wholly-owned subsidiary.

Our Alterra segment writes specialty insurance and reinsurance on a worldwide basis from offices in the United States, Bermuda, the United Kingdom, Europe and Latin America. The Alterra segment's Lloyd's operations are conducted by Alterra at Lloyd's through Lloyd's Syndicates 1400 and 2526. At September 30, 2013, the Company's proportionate share of Syndicates 1400 and 2526 was 100% and approximately 20%, respectively. Alterra also has a 2% share in the 2012 and prior underwriting years of Syndicate 2525. Business written by the Alterra segment includes a wide range of commercial insurance and reinsurance products, including general and excess liability, property, accident and health, agriculture, auto, credit/surety, marine and energy, medical malpractice, professional liability and workers compensation coverages.

For purposes of segment reporting, the Other Insurance (Discontinued Lines) segment includes lines of business that have been discontinued in conjunction with acquisitions. Alterra previously offered life and annuity reinsurance products. In 2010, Alterra ceased writing life and annuity reinsurance contracts and placed this business into run-off. Results attributable to the run-off of Alterra's life and annuity reinsurance business are included in the Company's Other Insurance (Discontinued Lines) segment. This segment also includes development on asbestos and environmental loss reserves, none of which are related to the acquisition of Alterra.

Through our wholly-owned subsidiary Markel Ventures, Inc., we own interests in various industrial and service businesses that operate outside of the specialty insurance marketplace. These businesses are viewed by management as separate and distinct from our insurance operations and are comprised of a diverse portfolio of companies from different industries, including manufacturing, health care and business and financial services. Local management teams oversee the day-to-day operations of these companies, while strategic decisions are made in conjunction with members of our executive management team, principally our President and Chief Investment Officer. The financial results of those companies in which we own controlling interests have been consolidated in our financial statements. The financial results of those companies in which we hold a noncontrolling interest are accounted for under the equity method of accounting.

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Our strategy in making these private equity investments is similar to our strategy for purchasing equity securities. We seek to invest in profitable companies, with honest and talented management, that exhibit reinvestment opportunities and capital discipline, at reasonable prices. We intend to own the businesses acquired for a long period of time.

On October 9, 2013, we made an offer to purchase the entire issued and to be issued share capital of Abbey Protection plc (Abbey), an integrated specialist insurance and consultancy group, for a total purchase price of approximately £116.5 million (approximately $187.4 million as of October 9, 2013). The acquisition is subject to a number of conditions, including shareholder and regulatory approvals in the United Kingdom. If approved, the transaction is expected to close in January 2014. Abbey's business is focused on the underwriting and sale of insurance products to small and medium enterprises and affinity groups in the United Kingdom providing protection against legal expenses and professional fees incurred as a result of legal actions or investigations by tax authorities, as well as providing a range of complementary legal, professional and reinsurance services.

Regulatory Environment

Our insurance subsidiaries are subject to regulation and supervision by the insurance regulatory authorities of the various jurisdictions in which they conduct business. As a result of our acquisition of Alterra, we became subject to regulatory authorities in Bermuda, Ireland and certain other foreign jurisdictions. The following discussion should be read in conjunction with our 2012 Annual Report on Form 10-K, which provides a more complete description of our regulatory environment.

Bermuda Insurance Regulation

The insurance and reinsurance industry in Bermuda is regulated by the Bermuda Monetary Authority (the BMA). Markel Bermuda is regulated by the BMA under the Insurance Act 1978 of Bermuda and its related regulations (collectively, the Bermuda Insurance Act). The Bermuda Insurance Act imposes solvency and liquidity standards and auditing and reporting requirements on Markel Bermuda and grants to the BMA powers to supervise, investigate and intervene in the affairs of Bermuda insurance and reinsurance companies.

Markel Bermuda's business is subject to enhanced capital requirements in addition to minimum solvency and liquidity requirements. The enhanced capital requirement is determined by reference to a risk-based capital model that determines a control threshold for statutory capital and surplus by taking into account the risk characteristics of different aspects of the insurer's business. If a company fails to maintain or meet the control level, various degrees of regulatory action may be taken by the BMA.

Markel Bermuda is also subject to the Insurance Code of Conduct (the Insurance Code), which prescribes duties and standards to be complied with to ensure that Markel Bermuda implements sound corporate governance, risk management and internal controls. Non-compliance with the Insurance Code could result in intervention by the BMA. The BMA also monitors each insurer's compliance with the Insurance Code and may use it as a factor in calculating the applicable operational risk charge in relation to that insurer's risk-based capital model.

In addition, our Bermuda incorporated entities are each required to comply with the provisions of the Companies Act 1981 of Bermuda (the Bermuda Companies Act). The Bermuda Companies Act regulates, among other things, the payment of dividends and making of distributions from contributed surplus.

Ireland Insurance Regulation

The insurance and reinsurance industry in Ireland is regulated by the Central Bank of Ireland (the CBI). Our Irish operating subsidiary, Markel Europe plc (Markel Europe, formerly known as Alterra Europe), is subject to regulation by the CBI under a variety of Irish rules and regulations. Markel Europe must comply with the Irish Insurance Acts 1909 to 2011, regulations promulgated thereunder, regulations relating to insurance business promulgated under the European Communities Act 1972, the Irish Central Bank Acts 1942 to 2010, as amended, regulations promulgated thereunder and directions and guidelines and codes of conduct issued by the CBI (collectively, the Insurance Acts and Regulations).

Markel Europe is required to maintain statutory reserves, particularly in respect of underwriting liabilities, and a solvency margin as provided for in the Insurance Acts and Regulations. Assets constituting statutory reserves must comply with admissibility, diversification, localization and currency matching rules. Statutory reserves must be actuarially certified annually.

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Other Jurisdictions

As a global provider of specialty insurance and reinsurance, we must comply with various regulatory requirements in jurisdictions where we provide coverage or have activities in addition to the United States, the United Kingdom, Bermuda and Ireland. For example, Markel Europe and Alterra at Lloyd's must comply with applicable Latin America regulatory requirements in connection with our Latin American reinsurance operations, and Markel Europe must comply with applicable German and Swiss regulatory requirements in connection with its branch activities in those countries.

In addition to the regulatory requirements imposed by the jurisdictions in which a reinsurer is licensed, a reinsurer's business operations are affected by regulatory requirements governing credit for reinsurance in other jurisdictions in which its ceding companies are located. In general, a ceding company that obtains reinsurance from a reinsurer that is licensed, accredited or approved by the jurisdiction in which the ceding company files statutory financial statements is permitted to reflect in its statutory financial statements a credit in an aggregate amount equal to the liability for unearned premiums and loss reserves and loss expense reserves ceded to the reinsurer. Many jurisdictions also permit ceding companies to take credit on their statutory financial statements for reinsurance obtained from unlicensed or non-admitted reinsurers if certain prescribed security arrangements are made. Because Markel Bermuda is not licensed, accredited or approved in any jurisdiction other than Bermuda, in certain instances our reinsurance customers require Markel Bermuda to provide a letter of credit or enter into other security arrangements.

Key Performance Indicators

We measure financial success by our ability to compound growth in book value per share at a high rate of return over a long period of time. To mitigate the effects of short-term volatility, we measure ourselves over a five-year period. We believe that growth in book value per share is the most comprehensive measure of our success because it includes all underwriting and investing results. We measure underwriting results by our underwriting profit or loss and combined ratio. We measure investing results by our total investment return. These measures are discussed below in greater detail under "Results of Operations."

Results of Operations

The following table presents the components of net income to shareholders.

	Quarter Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	2013	2012	2013	2012
Underwriting profit (loss)	$34,225	$(4,763)	$61,561	$64,793
Net investment income	86,192	64,438	228,788	207,834
Net realized investment gains	11,238	5,231	40,701	25,356
Other revenues	174,512	165,569	504,680	385,778
Amortization of intangible assets	(16,848)	(7,959)	(37,755)	(25,078)
Other expenses	(166,566)	(145,339)	(459,642)	(343,462)
Interest expense	(30,619)	(24,692)	(82,754)	(69,068)
Income tax expense	(25,167)	(811)	(70,673)	(45,998)
Net income attributable to noncontrolling interests	(1,368)	(2,021)	(2,649)	(3,562)
Net income to shareholders	$65,599	$49,653	$182,257	$196,593

Net income to shareholders for the quarter ended September 30, 2013 increased primarily due to more favorable underwriting results and higher investment income, partially offset by higher income tax expense compared to the same period of 2012. Net income to shareholders for the nine months ended September 30, 2013 decreased primarily due to an increase in amortization expense, interest expense and income tax expense, partially offset by higher investment income compared to the same period of 2012. In both periods of 2013, higher investment income and increased amortization expense, interest expense and income tax expense are due in part to including the results of operations of Alterra beginning May 1, 2013. The components of net income to shareholders are discussed in further detail under "Underwriting Results," "Investing Results," "Non-Insurance Operations" and "Interest Expense and Income Taxes."

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Underwriting Results

Underwriting profits are a key component of our strategy to grow book value per share. We believe that the ability to achieve consistent underwriting profits demonstrates knowledge and expertise, commitment to superior customer service and the ability to manage insurance risk. The property and casualty insurance industry commonly defines underwriting profit or loss as earned premiums net of losses and loss adjustment expenses and underwriting, acquisition and insurance expenses. We use underwriting profit or loss as a basis for evaluating our underwriting performance.

The following table presents selected data from our underwriting operations.

	Quarter Ended September 30,				Nine Months Ended September 30,			
(dollars in thousands)	2013		2012		2013		2012	
Gross premium volume	$1,076,298		$610,833		$2,920,578		$1,906,373	
Net written premiums	$842,931		$539,624		$2,433,200		$1,687,404	
Net retention	78	%	88	%	83	%	89	%
Earned premiums	$919,723		$530,537		$2,269,129		$1,573,189	
Losses and loss adjustment expenses	$533,372		$303,459		$1,263,674		$813,074	
Underwriting, acquisition and insurance expenses	$352,126	(1)	$231,841	(2)	$943,894	(1)	$695,322	(2)
Underwriting profit (loss)	$34,225		$(4,763	)	$61,561		$64,793	
U.S. GAAP Combined Ratios (3)								
Excess and Surplus Lines	88	%	89	%	81	%	91	%
Specialty Admitted	90	%	109	%	101	%	108	%
London Insurance Market	84	%	92	%	88	%	88	%
Alterra	104	%	—	%	118	%	—	%
Other Insurance (Discontinued Lines)	NM	(4)	NM	(4)	NM	(4)	NM	(4)
Markel Corporation (Consolidated)	96	%	101	%	97	%	96	%

(1) In connection with the acquisition of Alterra, we incurred transaction and other acquisition-related costs of $8.5 million and $70.3 million for the quarter and nine months ended September 30, 2013, respectively. For the nine months ended September 30, 2013, these costs include transaction costs totaling $16.0 million, which primarily consist of due diligence, legal and investment banking costs. The quarter and nine months ended September 30, 2013 also include severance costs of $3.5 million and $31.7 million, respectively, stay bonuses of $3.9 million and $10.0 million, respectively, and other compensation costs totaling $1.1 million and $12.6 million, respectively, related to the acceleration of certain long-term incentive compensation awards and restricted stock awards that were granted by Alterra prior to the acquisition.

(2) Effective January 1, 2012, we prospectively adopted Financial Accounting Standards Board Accounting Standards Update (ASU) No. 2010-26, Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. At December 31, 2011, deferred policy acquisition costs included $43.1 million of costs that no longer met the criteria for deferral as of January 1, 2012 and were recognized into income during 2012, consistent with policy terms ($6.5 million and $41.1 million for the quarter and nine months ended September 30, 2012, respectively).

(3) The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums. A combined ratio less than 100% indicates an underwriting profit, while a combined ratio greater than 100% reflects an underwriting loss.

(4) NM – Ratio is not meaningful.

Our combined ratio was 96% and 97%, respectively, for the quarter and nine months ended September 30, 2013 compared to 101% and 96%, respectively for the same periods of 2012. For the quarter ended September 30, 2013, the decrease in the combined ratio was driven by a lower current accident year loss ratio and a lower expense ratio, partially offset by a lower prior accident years loss ratio compared to the same period in 2012. For the nine months ended September 30, 2013, the increase in the combined ratio was due to a lower prior accident years loss ratio, partially offset by a lower expense ratio.

The decrease in the consolidated current accident year loss ratio for the quarter ended September 30, 2013 was primarily due to more favorable underwriting results within our Specialty Admitted segment compared to 2012. Additionally, the quarter ended September 30, 2012 included $8.8 million, or two points, of losses from Hurricane Isaac which occurred in August 2012.

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The consolidated combined ratio for the quarter and nine months ended September 30, 2013 included $77.3 million and $281.4 million, respectively, of favorable development on prior years' loss reserves compared to $69.3 million and $260.2 million of favorable development for the same periods in 2012. Favorable development on prior years' loss reserves for the quarter and nine months ended September 30, 2013 included $5.6 million and $19.7 million, respectively, of favorable development on Hurricane Sandy which occurred during October 2012. In both periods of 2013, the benefit of the favorable development on prior years' loss reserves had less of an impact on the combined ratio in 2013 compared to 2012 due to higher earned premium volume in 2013.

The decrease in the consolidated expense ratio for both the quarter and nine months ended September 30, 2013 was primarily driven by higher earned premiums in our Excess and Surplus Lines, Specialty Admitted and London Insurance Market segments compared to 2012, partially offset by the impact of transaction and other acquisition-related costs incurred by Alterra. Excluding transaction and other acquisition-related costs incurred in 2013, the inclusion of the results of operations of Alterra beginning May 1, 2013 had a favorable impact on the expense ratio for the quarter and nine months ended September 30, 2013, as Alterra has a lower expense ratio than we historically have had.

Underwriting, acquisition and insurance expenses for the quarter and nine months ended September 30, 2013 include transaction and other acquisition-related costs of $8.5 million, or one point, and $70.3 million, or three points, respectively. For the nine months ended September 30, 2013, these costs include transaction costs totaling $16.0 million, which primarily consist of due diligence, legal and investment banking costs. The quarter and nine months ended September 30, 2013 also include severance costs of $3.5 million and $31.7 million, respectively, stay bonuses of $3.9 million and $10.0 million, respectively, and other compensation costs totaling $1.1 million and $12.6 million, respectively, related to the acceleration of certain long-term incentive compensation awards and restricted stock awards that were granted by Alterra prior to the acquisition. We expect to recognize additional costs totaling $8.9 million through May 1, 2014 associated with the payment of stay bonuses, which were awarded to certain employees of Alterra provided they remain employed one year from the Acquisition Date.

The prospective adoption of ASU No. 2010-26 during the first quarter of 2012 increased our underwriting, acquisition and insurance expenses for the quarter and nine months ended September 30, 2012 by approximately $6.5 million, or one point on the combined ratio and $41.1 million, or three points on the combined ratio, respectively.

Excess and Surplus Lines Segment

The combined ratio for the Excess and Surplus Lines segment was 88% and 81%, respectively, for the quarter and nine months ended September 30, 2013 compared to 89% and 91%, respectively, for the same periods of 2012. For the quarter ended September 30, 2013, less favorable development of prior accident years' loss reserves was offset by a lower expense ratio compared to the same period of 2012. For the nine months ended September 30, 2013, the combined ratio decreased due to more favorable development on prior accident years' loss reserves and a lower expense ratio compared to the same period of 2012.

The Excess and Surplus Lines segment's combined ratio for the quarter and nine months ended September 30, 2013 included $40.8 million and $165.6 million, respectively, of favorable development on prior years' loss reserves compared to $51.3 million and $132.6 million of favorable development for the same periods in 2012. The redundancies on prior years' loss reserves experienced within the Excess and Surplus Lines segment during both periods of 2013 and 2012 were most significant on our casualty product lines across several accident years. Additionally, the quarter and nine months ended September 30, 2013 included $5.0 million and $16.7 million, respectively, of favorable development on Hurricane Sandy.

The improvement in the Excess and Surplus Lines segment's expense ratio for both the quarter and nine months ended September 30, 2013 was primarily due to higher earned premiums and lower general expenses compared to the same periods last year. The prospective adoption of ASU No. 2010-26 during the first quarter of 2012 increased underwriting, acquisition and insurance expenses for the quarter and nine months ended September 30, 2012 by approximately $2.1 million, or one point on the combined ratio, and $16.7 million, or three points on the combined ratio, respectively.

Specialty Admitted Segment

The combined ratio for the Specialty Admitted segment was 90% and 101%, respectively, for the quarter and nine months ended September 30, 2013 compared to 109% and 108%, respectively, for the same periods of 2012. In both periods of 2013, the combined ratio benefited from a lower current accident year loss ratio and more favorable development of prior accident years' loss reserves compared to the same periods of 2012.

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The lower current accident year loss ratio for both the quarter and nine months ended September 30, 2013 was primarily due to more favorable rates on our workers' compensation business and to a higher proportion of non-California workers' compensation business (which carries a lower loss ratio) being written by our Markel FirstComp unit during 2013 compared to 2012. Also contributing to the lower current accident year loss ratio in 2013 was the contribution of premium from the Hagerty business, which also carries a lower loss ratio. For the quarter ended September 30, 2013, we also experienced improved underwriting performance within our Markel Specialty unit across several product lines. The current accident year loss ratio for the quarter and nine months ended September 30, 2012 included $2.8 million, or two points and one point, respectively, of losses from Hurricane Isaac.

The Specialty Admitted segment's combined ratio for the quarter and nine months ended September 30, 2013 included $28.4 million and $45.9 million, respectively, of favorable development on prior years' loss reserves compared to $11.5 million and $27.7 million of favorable development for the same periods in 2012. The redundancies on prior years' loss reserves experienced within the Specialty Admitted segment during both periods of 2013 were most significant on the non-California workers' compensation business at our Markel FirstComp unit on the 2011 and 2012 accident years.

The expense ratio for the Specialty Admitted segment for the quarter and nine months ended September 30, 2013 was impacted by commission expense on the Hagerty business, which has a higher overall commission rate. For the quarter and nine months ended September 30, 2013, the impact of the Hagerty commission expense was offset by the impact of the prospective adoption of ASU No. 2010-26 during the first quarter of 2012, which increased underwriting, acquisition and insurance expenses for the quarter and nine months ended September 30, 2012 by approximately $2.6 million, or two points on the combined ratio, and $12.9 million, or three points on the combined ratio, respectively.

London Insurance Market Segment

The combined ratio for the London Insurance Market segment was 84% and 88%, respectively, for the quarter and nine months ended September 30, 2013 compared to 92% and 88%, respectively, for the same periods of 2012. For the quarter ended September 30, 2013, the decrease in the combined ratio was due to more favorable development on prior accident years' loss reserves and a lower expense ratio compared to the same period of 2012. For the nine months ended September 30, 2013, less favorable development of prior accident years' loss reserves was offset by a lower expense ratio compared to the same period of 2012.

The London Insurance Market segment's combined ratio for the quarter and nine months ended September 30, 2013 included $40.6 million and $101.6 million, respectively, of favorable development on prior years' loss reserves compared to $32.7 million and $119.0 million of favorable development for the same periods in 2012. For the quarter ended September 30, 2013, the favorable development on prior years' loss reserves was primarily on the 2008 to 2010 accident years in the Marine and Professional and Financial Risks divisions. For the nine months ended September 30, 2013, the favorable development on prior years' loss reserves was primarily on the 2008 to 2010 accident years in the Marine, Specialty and Elliott Special Risks divisions. Favorable development of prior years' loss reserves in both periods of 2012 was primarily on the 2006 to 2009 accident years and occurred in a variety of programs across each of our divisions. The loss reserve redundancies for the quarter and nine months ended September 30, 2013 also included $8.9 million and $18.7 million, respectively, of favorable loss reserve development on the 2001 and prior accident years, compared to $4.8 million and $23.0 million, respectively, in the same periods of 2012.

The improvement in the London Insurance Market segment's expense ratio for the quarter and nine months ended September 30, 2013 was due in part to higher earned premiums compared to the same periods last year and a lower overall commission rate, driven by a change in the mix of earned premiums. The prospective adoption of ASU No. 2010-26 during the first quarter of 2012 increased underwriting, acquisition and insurance expenses for the quarter and nine months ended September 30, 2012 by approximately $1.8 million, or one point on the combined ratio, and $11.6 million, or two points on the combined ratio, respectively.

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Alterra Segment

Following the completion of the acquisition of Alterra on May 1, 2013, we have included the underwriting results of Alterra in the Alterra segment. As a result, a comparison of current and prior year periods is not meaningful. For this reason, we have included certain financial information for the Alterra segment on a pro forma basis as if the acquisition of Alterra had occurred on January 1, 2012. The pro forma financial information discussed herein is for informational purposes only and does not necessarily reflect the results that would have occurred had the acquisition taken place on January 1, 2012, nor is it necessarily indicative of future results. Adjustments used to determine pro forma results include amortization of the fair value adjustment recorded for the difference between the fair value and historical carrying amount of Alterra's unpaid losses and loss adjustment expenses. We have also excluded certain charges from the pro forma results, including transaction costs incurred by us ($16.0 million) and Alterra ($23.0 million) totaling $39.0 million for the nine months ended September 30, 2013, severance costs attributable to the acquisition totaling $3.5 million and $31.7 million for the quarter and nine months ended September 30, 2013, respectively, and stay bonuses of $3.9 million and $10.0 million for the quarter and nine months ended September 30, 2013, respectively. The acceleration of compensation expense during the quarter and nine months ended September 30, 2013 related to Alterra's long-term incentive compensation awards and restricted stock awards was attributable to the acquisition; however, the incremental expense recognized during both periods of 2013 only represents a timing difference in the recognition of expense. Therefore, it was not excluded from the pro forma underwriting results.

The following table presents the underwriting results for the Alterra segment for the quarter ended September 30, 2013 and the period from May 1, 2013 to September 30, 2013, which are included in the consolidated statements of income and comprehensive income for the quarter and nine months ended September 30, 2013.

(dollars in thousands)	Quarter Ended September 30, 2013	May 1, 2013 to September 30, 2013
Earned premiums	$304,181	$529,668
Losses and loss adjustment expenses:		
Current accident year	(201,732)	(380,513)
Prior accident years	—	—
Underwriting, acquisition and insurance expenses:		
Transaction and other acquisition-related expenses [(1)]	(8,508)	(70,317)
All other expenses	(104,608)	(171,762)
Underwriting loss	$(10,667)	$(92,924)
U.S. GAAP combined ratio [(2)]	104%	118%

(1) In connection with the acquisition of Alterra, we incurred transaction and other acquisition-related costs of $8.5 million and $70.3 million for the quarter and nine months ended September 30, 2013, respectively. For the nine months ended September 30, 2013, these costs include transaction costs totaling $16.0 million, which primarily consist of due diligence, legal and investment banking costs. The quarter and nine months ended September 30, 2013 also include severance costs of $3.5 million and $31.7 million, respectively, stay bonuses of $3.9 million and $10.0 million, respectively, and other compensation costs totaling $1.1 million and $12.6 million, respectively, related to the acceleration of certain long-term incentive compensation awards and restricted stock awards that were granted by Alterra prior to the acquisition. The acceleration of compensation expense during the quarter and nine months ended September 30, 2013 was attributable to the acquisition; however, the incremental expense recognized during both periods of 2013 only represents a timing difference in the recognition of expense. Therefore, it was not excluded from the pro forma underwriting results.

(2) The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned

premiums.

The combined ratio for the Alterra segment was 104% for the quarter ended September 30, 2013 and 118% for the period from May 1, 2013 to September 30, 2013. The combined ratio for the Alterra segment included transaction and other acquisition-related costs of $8.5 million for the quarter ended September 30, 2013, or three points on the combined ratio, and $70.3 million for the period from May 1, 2013 to September 30, 2013, or 13 points on the combined ratio. The combined ratio for the quarter ended September 30, 2013 and the period from May 1, 2013 to September 30, 2013 also included $7.0 million, or two points, and $32.4 million, or six points, of underwriting loss related to catastrophes that occurred during 2013. Favorable development on prior years' loss reserves was $48.1 million for both the quarter ended September 30, 2013 and the period from May 1, 2013 to September 30, 2013, most of which was offset by the impact of applying our more conservative loss reserving philosophy to Alterra's current year loss reserves. For financial reporting purposes, favorable development on pre-acquisition accident years' loss reserves is included in current year losses and loss adjustment expenses.

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The following table presents the pro forma underwriting results for the Alterra segment for the quarter and nine months ended September 30, 2013 and 2012.

	Pro Forma Quarter Ended September 30,		Pro Forma Nine Months Ended September 30,	
(dollars in thousands)	2013	2012	2013	2012
Earned premiums	$304,181	$331,997	$978,271	$1,019,629
Losses and loss adjustment expenses	(200,996)	(228,210)	(647,848)	(633,663)
Underwriting, acquisition and insurance expenses:				
Transaction and other acquisition-related expenses [1]	(1,083)	—	(12,621)	—
All other expenses	(104,720)	(118,072)	(329,734)	(355,978)
Underwriting profit (loss)	$(2,618)	$(14,285)	$(11,932)	$29,988
U.S. GAAP combined ratio [2]	101%	104%	101%	97%

(1) In connection with the acquisition of Alterra, we incurred compensation costs totaling $1.1 million and $12.6 million, respectively, related to the acceleration of certain long-term incentive compensation awards and restricted stock awards that were granted by Alterra prior to the acquisition. The acceleration of compensation expense during the quarter and nine months ended September 30, 2013 was attributable to the acquisition; however, the incremental expense recognized during both periods of 2013 only represents a timing difference in the recognition of expense. Therefore, it was not excluded from the pro forma underwriting results.

(2) The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

The decrease in the Alterra segment's pro forma combined ratio for the quarter ended September 30, 2013 was due to a lower loss ratio and lower expense ratio. For the nine months ended September 30, 2013, the increase in the pro forma combined ratio was driven by a higher loss ratio.

For the quarter ended September 30, 2013, the decrease in the pro forma loss ratio was due in part to more favorable development of prior years' loss reserves compared to 2012, partially offset by the impact of applying our more conservative loss reserving philosophy to Alterra's current year loss reserves in 2013. The quarter ended September 30, 2013 included $48.1 million, or 16 points, of favorable development on prior years' loss reserves compared to $22.7 million, or seven points, of favorable development for the same period of 2012. The redundancies on prior years' loss reserves in 2013 were primarily in the global insurance and reinsurance divisions. The redundancies on prior years' loss reserves in 2012 were primarily in the reinsurance division. The decrease in the pro forma loss ratio for the third quarter of 2013 was also the result of a higher loss ratio in 2012 driven by large losses in the agriculture book as a result of severe drought conditions experienced in certain parts of the United States and higher catastrophe losses in 2012 compared to 2013. The Alterra segment's pro forma loss ratio for the quarter ended September 30, 2013 included $7.0 million, or two points, of catastrophe losses compared to $15.0 million, or five points, of catastrophe losses for the same period of 2012.

For the nine months ended September 30, 2013, the increase in the Alterra segment's pro forma loss ratio was driven by higher catastrophe losses compared to 2012 and the impact of applying our more conservative loss reserving philosophy to Alterra's current year loss reserves beginning May 1, 2013, partially offset by lower attritional losses in the agriculture book. The pro forma loss ratio for the nine months ended September 30, 2013 included $32.4 million, or three points, of catastrophe losses compared to $15.0 million, or one point, for the same period of 2012. The Alterra segment's pro forma loss ratio for the nine months ended September 30, 2013 included $68.7 million, or seven points, of favorable development on prior years' loss reserves compared to $53.8 million, or five points, of favorable development for the same period of 2012. In both years, favorable development on prior years' loss reserves was primarily in the global insurance and reinsurance divisions.

The Alterra segment's pro forma expense ratio for both the quarter and nine months ended September 30, 2013 reflects lower compensation and executive costs compared to the same periods in 2012. For the nine months ended September 30, 2013, the impact of lower compensation and executive costs was offset by $12.6 million of compensation costs associated with the acceleration of certain long-term incentive compensation awards and restricted stock awards that were granted by Alterra prior to the acquisition.

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Other Insurance (Discontinued Lines)

The Other Insurance (Discontinued Lines) segment produced an underwriting loss of $32.5 million and $31.4 million for the quarter and nine months ended September 30, 2013, respectively, compared to an underwriting loss of $26.7 million and $20.2 million for the same periods of 2012.

The underwriting loss for both the quarter and nine months ended September 30, 2013 included $28.4 million of loss reserve development on asbestos and environmental exposures, compared to $31.1 million for the quarter and nine months ended September 30, 2012. We complete an annual review of these exposures during the third quarter of the year unless circumstances suggest an earlier review is appropriate. Over the past few years, the number of asbestos and environmental claims reported each year across the property and casualty industry has been on the decline. However, at the same time, the likelihood of making an indemnity payment has risen, thus increasing the average cost per reported claim. During our 2012 annual review, we reduced our estimate of the ultimate claims count, while increasing our estimate of the number of claims that would ultimately be closed with an indemnity payment. During our 2013 annual review, our expectation of the severity of the outcome of known claims increased. As a result, prior years' loss reserves for asbestos and environmental exposures were increased. Asbestos and environmental loss reserves are subject to significant uncertainty due to potential loss severity and frequency resulting from an uncertain and unfavorable legal climate. Our asbestos and environmental reserves are not discounted to present value and are forecasted to pay out over the next 50 years. We seek to establish appropriate reserve levels for asbestos and environmental exposures; however, these reserves could be subject to increases in the future.

Adverse development of asbestos and environmental reserves for the quarter and nine months ended September 30, 2012 was partially offset by the other favorable movements in prior years' loss reserves and allowances for reinsurance bad debt related to discontinued lines of business originally written by Markel International.

The Other Insurance (Discontinued Lines) segment also included other revenues of $0.2 million and $0.5 million and other expenses of $8.8 million and $13.0 million for the quarter and nine months ended September 30, 2013, respectively, related to the life and annuity reinsurance business which was acquired through the acquisition of Alterra on May 1, 2013. This business is in run-off and we are not writing any new life and annuity reinsurance contracts; however, we will continue to recognize the existing life and annuity reinsurance obligations. The life and annuity benefit reserves are recorded on a discounted present value basis using assumptions that were determined at the Acquisition Date. The accretion of this discount and changes in reserves are recognized in the statement of income and comprehensive income as other expenses. Other revenues attributable to the Other Insurance (Discontinued Lines) segment represent ongoing premium adjustments on existing contracts.

Premiums and Net Retentions

The following tables summarize gross premium volume, net written premiums and earned premiums by segment.

Gross Premium Volume

	Quarter Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	2013	2012	2013	2012
Excess and Surplus Lines	$273,757	$253,014	$792,877	$705,849
Specialty Admitted	230,450	167,747	687,669	496,019
London Insurance Market	199,575	190,071	725,153	704,511
Alterra	372,516	—	714,844	—
Other Insurance (Discontinued Lines)	—	1	35	(6)
Total	$1,076,298	$610,833	$2,920,578	$1,906,373

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Gross premium volume for the quarter and nine months ended September 30, 2013 increased 76% and 53%, respectively, compared to the same periods of 2012. The increase in gross premium volume in both periods of 2013 was primarily attributable to the inclusion of premiums written by the Alterra segment from May 1, 2013, as well as higher gross premium volume in the Specialty Admitted and Excess and Surplus Lines segments. Gross premium volume in the Specialty Admitted segment increased 37% and 39% for the quarter and nine months ended September 30, 2013, respectively. The Specialty Admitted segment included $58.1 million and $152.5 million of gross written premiums from Hagerty for the quarter and nine months ended September 30, 2013, respectively, which we began writing in the first quarter of 2013. Gross premium volume in the Specialty Admitted segment for the quarter and nine months ended September 30, 2013 also included $34.6 million and $104.5 million, respectively, of gross premium volume attributable to Thomco, compared to $17.1 million and $43.4 million for the same periods of 2012. Gross premium volume for the quarter and nine months ended September 30, 2013 in our Excess and Surplus Lines segment increased 8% and 12%, respectively, due in part to the impact of more favorable rates and improving economic conditions. Foreign currency exchange rate movements did not have a significant impact on gross premium volume for the quarter and nine months ended September 30, 2013.

During 2012, we saw mid-single digit favorable rate changes across our portfolio as market conditions improved and revenues, gross receipts and payrolls of our insureds were favorably impacted by improved economic conditions. We have continued to see modest price increases across many of our product lines during 2013 and will continue to pursue price increases when possible; however, when we believe the prevailing market price will not support our underwriting profit targets, the business is not written. As a result of our underwriting discipline, gross premium volume may vary when we alter our product offerings to maintain or improve underwriting profitability.

On a pro forma basis, gross premiums written for the Alterra segment were $372.5 million and $1.6 billion for the quarter and nine months ended September 30, 2013, respectively, compared to $385.5 million and $1.6 billion, respectively, for the same periods of 2012.

Net Written Premiums

	Quarter Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	2013	2012	2013	2012
Excess and Surplus Lines	$232,396	$211,538	$673,741	$597,742
Specialty Admitted	219,955	157,894	655,350	467,722
London Insurance Market	174,203	170,193	634,180	621,947
Alterra	216,378	—	469,894	—
Other Insurance (Discontinued Lines)	(1)	(1)	35	(7)
Total	$842,931	$539,624	$2,433,200	$1,687,404

We purchase reinsurance in order to reduce our retention on individual risks and enable us to write policies with sufficient limits to meet policyholder needs. Net retention of gross premium volume for the quarter and nine months ended September 30, 2013 was 78% and 83%, respectively, compared to 88% and 89%, respectively, for the same periods of 2012. The decrease in net retention for the quarter and nine months ended September 30, 2013 was due to the inclusion of premiums written by Alterra beginning May 1, 2013, as Alterra uses higher levels of reinsurance than we have used historically. Net retention of gross premium volume in the Alterra segment was 58% for the quarter ended September 30, 2013 and 66% for the period from May 1, 2013 to September 30, 2013. Excluding premiums written by Alterra for the quarter and nine months ended September 30, 2013, our consolidated net retention of gross premium volume in 2013 would have been 89% for both the quarter and nine months ended September 30, 2013, which is consistent with 2012.

On a pro forma basis, net retention of gross premium volume in the Alterra segment for the quarter and nine months ended September 30, 2013 would have been 58% and 67%, respectively, compared to 68% and 67% for the same periods of 2012. The decrease in the Alterra segment's pro forma net retention for the quarter ended September 30, 2013 was driven by higher ceded premium on the aviation book within the global insurance division and Alterra at Lloyd's compared to 2012.

Earned Premiums

	Quarter Ended September 30,		Nine Months Ended September 30,	
(dollars in thousands)	2013	2012	2013	2012
Excess and Surplus Lines	$			